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## **Pension Insurance in the Republic of Bulgaria:**

### **Problems and Necessary Reforms**

**February 2011**

**Sofia**

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## Foreword

This study discusses some key issues of the pension insurance system (PINS) in the Republic of Bulgaria and the future necessary developments and reforms to be followed. Its aim is not to present an in-depth overall analysis of the current state of PINS, but rather to focus on certain major problems believed by the employers' organizations to be of utmost importance for the further improvement of legislation, institutions, financial stability, insurance contributions affordability and pension income adequacy. The accent is on the public segment of PINS, or the so-called first pillar. Nonetheless certain issues of supplementary pension insurance within the universal, occupational and voluntary pension insurance (so-called second and third pillars) are also highlighted in some parts of the paper.

It should be noted that the views discussed there primarily express the personal beliefs and positions of the authors nominated by the five employers' organizations - members of the Association of the Organizations of Bulgarian Employers (AOBE). Of course some of the propositions also reflect the officially stated positions of the respective employers' organizations.

Set up as a coordination body to represent the Bulgarian employers at the International Labor Conference and the International Organization of Employers, AOBE has won recognition as a platform for exchange of opinions, information, and experience in industrial relations. Common official positions on industrial relations are more often adopted with the support of AOBE. The recent examples include the consolidated positions in the tripartite and bipartite consultations with the other social partners within the framework of National Council for Tripartite Cooperation. This especially concerns the rules, measures and current development of the pension reform, the negative attitudes towards introducing draft legislation affecting the employers' freedom of association and the enforcement of the so-called "anti-crisis" measures adopted at the beginning of 2010.

The authors assigned by AOBE-member organizations and the research coordinators from the Bulgarian Industrial Association would like to express their gratitude to the ILO and ILO-SRO based in Budapest, and especially to Ms Anne Knowles, for their kind cooperation and assistance.

The study consists of ten major parts. It presents the current employment trends, the status of self-employed persons in PINS, as well as some possibilities for extension of its scope. The comparative analysis of the other EU-member states has shown that the number of persons covered in Bulgaria is almost twice higher in relative terms, having increased by over 20.6 percent over the period of 2004-2009 alone. Self-employed people have generally been found to pay contributions based only on the preset minimum insurance income. Therefore a differentiated approach is supported of setting minimal social security thresholds by occupations for self-employed persons. .Proposals are now made for extending the scope of pension insurance to self-employed in the agricultural sector, for reviewing the

criteria in awarding guaranteed minimum pension benefits for self-employed who have paid insurance contributions based on the minimum wage income, for improving the collection rates, etc.

The issues concerning state employees' entitlement to early retirement, including state defense and national security employees, require new solutions. Thus some changes are suggested in the status of the government as an employer and insurer of equal status, with legal and financial obligations on a par with the other insurers. Payment of individual social insurance contributions is proposed, at the expense of the respective administrative budgets, as is the case with all other people employed in the economy. In order to attain justice and equality in setting the amount of pension benefits for such persons, the impact of a number of factors, such as retirement age, years of pension benefits received, insurance coverage of the respective entitlements and privileges, etc., should be objectively reviewed and appreciated. To that end a review of the insurance contribution rates on the basis of relevant estimates and actuarial prognoses is also suggested.

Despite the decisions made recently, the rise of the retirement age in Bulgaria is one of the issues to be further debated. Based on an analysis included in the Green Book on basic demographic challenges in EU, the EC has recommended significant increase of the retirement age in all member-states. Obviously Bulgaria as a EU-member state in the worst demographic and migration situation should seek adequate long-term solutions for the future modernization of the Bulgarian pension system and address the new economic, demographic and social challenges. Hence, the idea concerning the inevitable rise of the qualifying period is being supported, even though the retirement age has already been increased over the 2000-2009 period from 60 to 63 for men and from 55 to 60 years for women.

Increasing the amount of social security contributions is not perceived as the main objective and instrument for enhancing PINS operation and financial stability. It is just one of the means for reaching a balance and overcoming the growing financial deficits in the public segment of social security that keep growing through the years, especially in the pension insurance system. The view is maintained that one should select appropriate criteria in contributions setting. They should be transparent, specific and easy to apply. Increase in revenues alone cannot resolve all problems. The pension insurance system should be stripped off of all irrelevant functions and expenditures, unnecessary costs and quasi-deficits should be limited, including the possibilities for inexpedient and illegitimate social security entitlements and early retirement. At the same time the control should be tightened and measures should be taken to expand the insurance base and shrink the so-called informal sector of the economy (i.e. insurance contributions based on actually paid remuneration for all employed people). A set of measures is proposed rather than random changes with a transient resource-limited effect upon PINS.

Pension insurance differentiation by sectors is viewed from two angles – differentiation within the

pension system and differentiation of the insured within the so-called public social insurance. An analysis is made of the scope and structure of the insured persons in the pension system and new alternative solutions are offered.

The impact of increased contributions' rates on rising unemployment is analyzed and a package of future necessary changes in PINS is argued for. The impact of the current economic crisis on financial balance is discussed as well as the collection rate in PINS, the labor market, the changes of wages and insurance income and the pressure for extending the so-called "grey sector". The need for in-depth actuary assessment of the contribution rates is further expounded. The focus is on the continuing decline of employment in the situation of crisis and the parallel impact of the higher insurance income threshold, the size of the insurance contributions and the growing labour costs.

The need of introducing a fairer distribution of social security expenditures between employers and employees/workers is reviewed by arguing in favour of a number of proposals. It is believed that PINS financial difficulties call for an overall change in its philosophy of reform with a focus on the financial security and not underestimating the demographic dimension. Relative reduction of the employers' contributions is proposed as a means to encourage the economic activity and improve competitiveness. It is imperative to introduce equivalent distribution as initially envisaged by (50:50%) splitting of contributions between employers and employees with a tendency towards strengthening the capital-funded principle of voluntary and the voluntary pension insurance and ensuring mutual control between insured and insurers.

The interdependence between insurance contributions due and actual amounts awarded as pension benefits is exhaustively analyzed in the context of the capital-funded and pay-as-you-go pension systems. The review of the Bulgarian social insurance legislation and practices has shown that the relationship between contributions paid and pensions received for particular age and qualifying period of service is manifested in the pension benefit setting formula under the pay-as-you-go scheme. Under the capital-funded principle of financing this relationship is manifest in the pension setting rules. The two forms of manifestation of that relationship mentioned above are subjected to a thorough analysis as a basis of formulating a number of proposals.

The historical aspects of labour categorization in Bulgaria are analyzed in depth in the section concerning early retirement due to hazardous working conditions. It offers a detailed study of the most recent changes in early retirement system and expresses the concern that the PINS amendments, enforced on 1 January 2011, are in danger of largely repeating the mistakes and defects of previous practices. That is equally true of both categories of employees entitled to early retirement. From an employers' point of view and taking into account the need to alleviate the pressure on the predominant third category (general working conditions), the priority should be the better definition and application

of adequate transparent labor categorization criteria. It is believed that the differentiation by categories, age, employer-employee expenditures, class of economic activity and other criteria should be gradually eliminated. The capital-funded pension system should be developed as a priority and its share should be increased in as far as the insured persons will be motivated to accrue funds as individual contributions in their personal accounts and to using them after reaching an optimal qualifying age and terms of service.

The section devoted to the interaction of PINS and the effective Currency Board system in Bulgaria offers a short overview of its establishment, typology and operation. Some basic performance indicators of the monetary and fiscal policy and the links with PINS in the period of 1997-2010 are analyzed. It traces down The links between the fiscal reserves as part of the liabilities under the Currency Board and the transfers and subsidies to cover social spending deficits in the consolidated fiscal program are also traced out, in particular those of the PINS public segment. The interrelation between the money supply (M3) under the Currency Board and the fiscal reserve framing the growth of both the revenues and the potential PINS expenditures is also substantiated. Also explained is the need for abstaining from a radical rise of insurance contribution and tax rates in the medium-term in view of Bulgaria's officially stated intentions to apply and accede to the preparatory mechanism of the Eurozone - ERM II. There should be a preparation and implementation of Additional subsequent reforms should be prepared and implemented to guarantee PINS stability, especially in the context of the current global economic crisis. Also presented are some key measures for attaining a balance between social insurance contributions and pension benefit eligibility, eliminating the possibilities for illegal entitlements to early pensions, narrowing down the scope for persons entitled to early retirement and tighter control and collection, as well as some other proposals, some of them already presented in the previous sections.

The research coordinators and authors of this Foreword, Dimitar Brankov and Grigor Dimitrov, would like to express their gratitude to all authors and managements of the AOBЕ member organizations for their support in the elaboration of this study.

**Sofia, 18 January 2011**

## 1. Extending the Scope and Coverage of Self-Employed/Self-Insured Persons

The paper analyzes the coverage of self-employed persons in pension insurance in Bulgaria. It presents the trends of employment among self-employed, its status and some possibilities for extending their coverage by pension insurance.

In its employment categories by status NSI defines “*self-employed*” as persons involved in economic activities on their own account rather than employing other persons. On the other hand, according the ILO methodology, the category of “*self-employed persons*” includes own-account self-employed persons (employed on their own account), employers and members of producer cooperatives. In the context of these definitions and to avoid any ambiguities concerning the content of that term, we have adopted the use of “self-employed” persons as a category referring to both self-employed persons (on their own account) and employers. In the Social Security Code (SSC) the self-insured persons are defined as sole traders, proprietors or partners in trade companies, farmers, tobacco producers and persons pursuing registered liberal occupations or craft activities.

Own account pension insurance is addressed in the national legislation in compliance with the EU regulations concerning the coordination of the international cooperation in that sphere. SSC defines the insurance of self-employed persons for three of the eight social security contingencies covered by NSSI as mandatory, namely, disability due to general illness, old age and demise. Supplementary pension insurance is mandatory for persons born after 31.12.1959. Also regulated are the voluntary supplementary pension insurance options. Furthermore, the parameters, terms and procedures of pension insurance are defined specifically in supportive statutes, rules and regulations.

Analyses indicate that the coverage of self-employed is different in the individual countries due to the differences in their demographic and economic development as reflected in their respective legislation. Thus self-employed in a number of countries subscribe to pension insurance voluntarily and that fact determines the low percentage of persons covered by pension insurance. Data on Bulgaria are nearly twice higher (Fig. 1) as compared to the average level of coverage of self-employed in the countries from Western, Central and Eastern Europe,

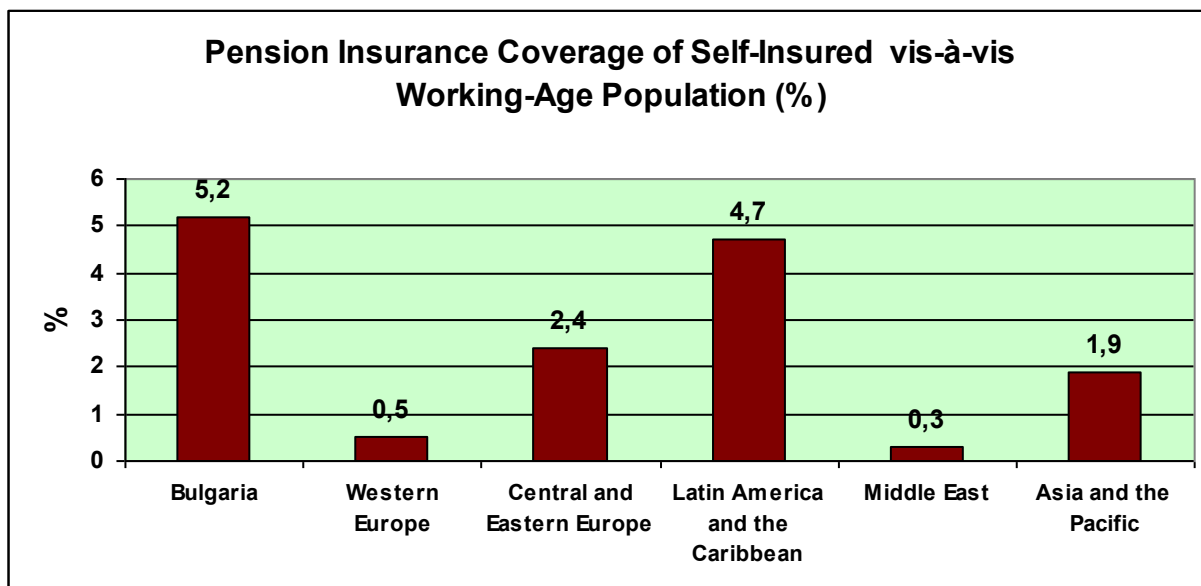


Figure 1. Pension insurance coverage of self-insured vis-à-vis working-age population. Data source: World Social Report 2010, ILO and NSI.

## Employment

Among the important factors for the state of coverage extended to self-employed persons is their employment. Over the 2004-2009 period the dynamics in the total number of employed persons point to continuous growth, reaching a peak in 2008 - 3360,7 thousand people. The subsequent decline in 2009 by over 100 000 people is a direct outcome of the economic crisis. The number of self-employed in 2004 had been 381,6 thousand and before 2007 it fell by about 16 thousand people (Fig.2). Over the next two years it was growing, reaching 372,8 thousand people in 2009. Different trends have also been observed in the sub-group of self-employed and in that of employers. Between 2004 and 2007 the number of self-employed dropped by some 36,6 thousand people and employers increased by about 20 000. In 2008 the number of self-employed rose with 25 900 as compared to 2007 and the decline registered in 2009 was barely 0,5 thousand people. Conversely the trend in the number of employers continued to deteriorate after 2007 and by 2009 their number dropped by 18,4 thousand people.

In 2009 self-employed accounted for 8% and employers - for 3,5%, or both sub-groups in total accounted for 11,5% within the structure of all employed people.



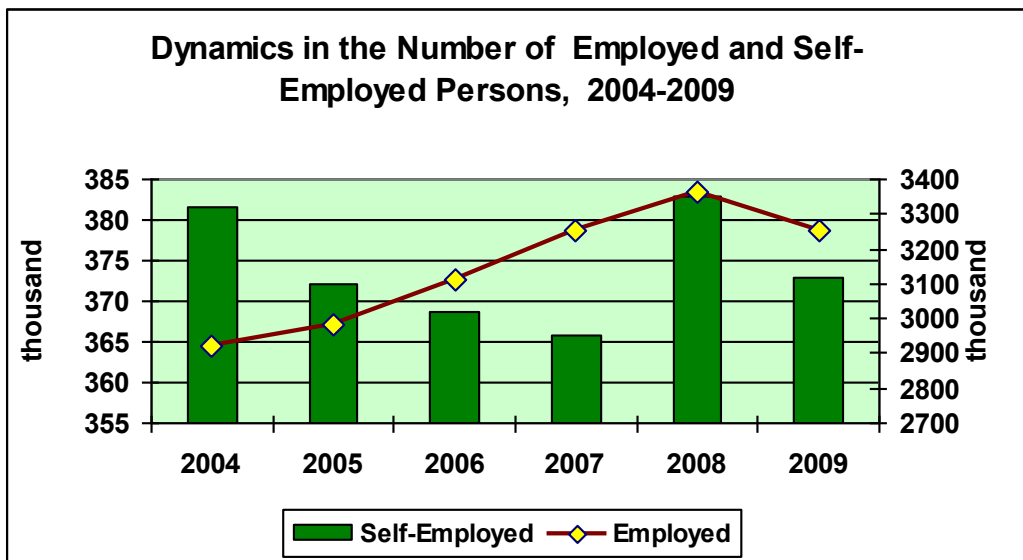


Figure 2. Dynamics in the number of employed and self-employed persons, 2004-2009. Data source: NSI

### Pension Insurance Coverage of Self-Employed

Pension insurance coverage of self-employed is estimated with the help of two key indicators: number of self-employed and share of self-insured in the number of self-employed. The trends in the number of self-insured and self-employed persons over the 2004-2009 period is presented on Fig. 3. In contrast to the fluctuating number of self-employed, the number of self-insured is constantly growing. In 2009 the number of self-insured rose significantly by 37.7 points compared to 2004.

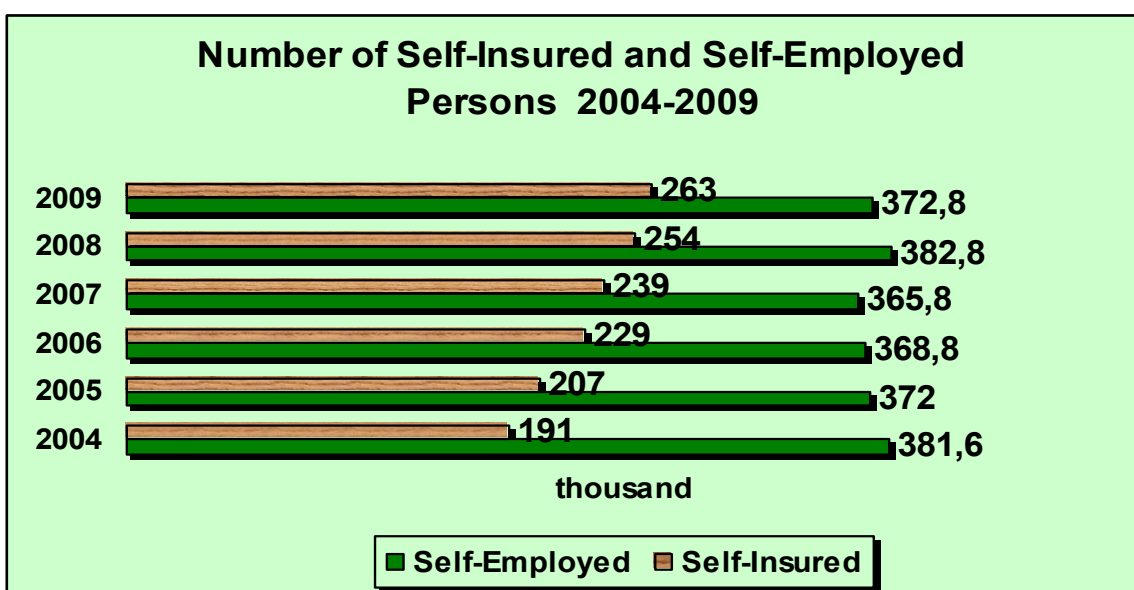


Figure 3. Number of self-insured and self-employed persons, 2004-2009. Data source: NSI and NSSI

Under the SSC pension insurance of self-employed persons is mandatory in one of two options: either for all social insurance contingencies or only for retirement; therefore the pension insurance coverage

of self-employed persons is 100% by law. According to the ILO method the coverage of pension insurance for self-employed is the share of effectively self-insured persons in the total number of self-employed persons at the end of a specific period. The trend of continuous growth of pension insurance coverage among self-employed persons over the 2004-2009 period is clearly shown on Figure 4, though it has slowed down in the past few years. In 2009 the coverage grew by 20,6% as compared to 2004.

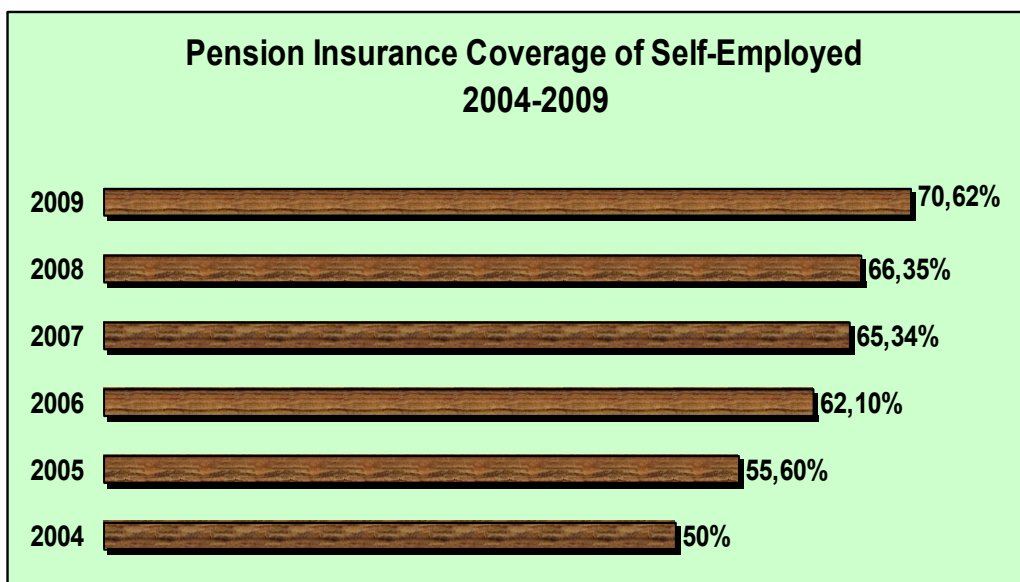


Figure 4. Pension insurance coverage of self-employed, 2004-2009. Data source: NSSI and NSI

Self-employed people account for 9,3% of all insured person paying contributions. 54% of all self-insured are covered for all social contingencies and 46% - only for pensions (2009). After 2004 the trend of insurance for pensions only has weakened while insurance plans for all insurance contingencies (including pension insurance ) have been increasing (Fig.5).

The insurance thresholds are determined every year; in 2009 the minimum monthly insurance income amounted to 260,00 BGN; for farmers and tobacco producers – to 130,00 BGN and only for farm activities - to 65,00 BGN. The average monthly income as a base for insurance contributions payment was 242,19 BGN, or twice lower than the average monthly insurance income for insured persons with contributions (554,78 BGN) in 2009. Although the maximum insurance income in 2009 was 2000,00 BGN, there is no practical indication of high income insurance among self-insured. Low incomes are a serious reason for that, although incomes in some liberal occupations permit payment of much higher contributions. The contributions from self-insured account for only 4.45% of the revenues from insurance contributions and in the structure of revenues received from all sources of funding throughout the year (2009) their share is even lower – 2.84% .

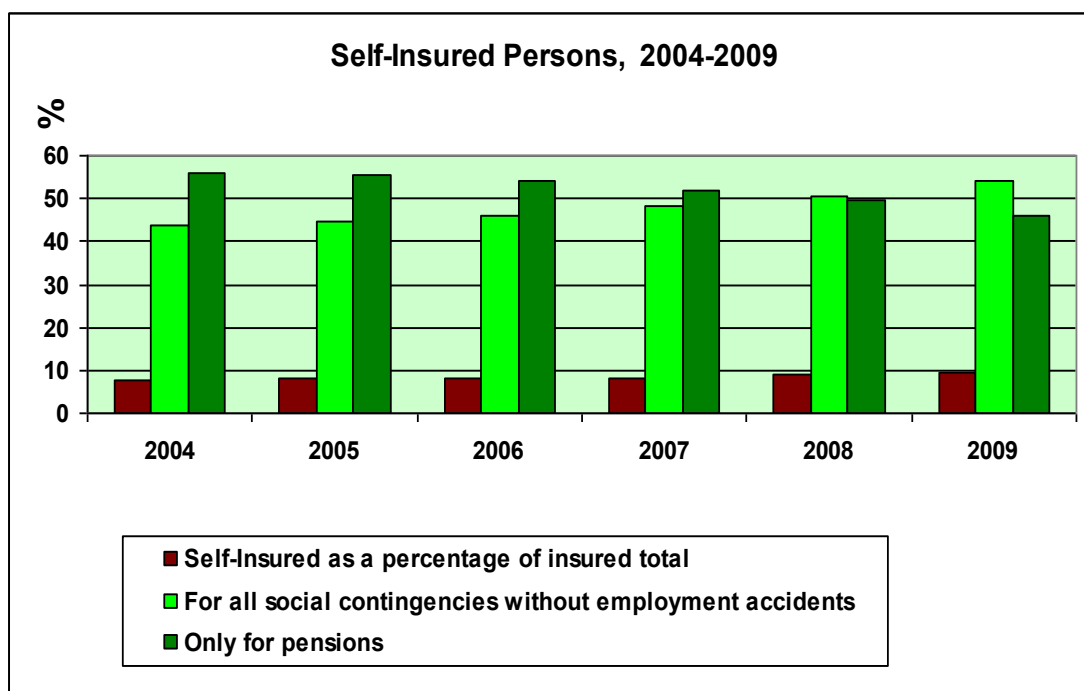


Figure 5. Self-insured persons. Data source: NSSI

In an effort to improve the adequacy of pension self-insurance the minimal monthly pension insurance income was increased to 420.00 BGN in 2010. Some even more substantial changes are also introduced in the State Social Security Budget Act for 2011 where the insurance income is tied up with the amount of declared yearly incomes. The minimum insurance income for farmers and tobacco producers is set at 240.00 BGN, or almost twice higher as compared to 2009. The insurance contribution is also raised to 17,8%. The contributions from self-insured persons in the contribution revenues in the Pension Fund accounted for only 5,3% and in the revenue structure from all sources during the year of the same Fund the share of insurance contributions made by self-insured is even lower - 3,1% (2009).

### Major Conclusions

The pension insurance of self-employed persons and the issues arising in that area are part of the problems facing the national pension systems as a result of the demographic, economic and political processes in the respective country.

Typical for Bulgaria in the period of restructuring of the economy is the extended scope for self-employed, so that its levels are practically higher than the average in Western, Central and Eastern Europe. At the same time we come against a paradox that seriously influences the social and economic price of that fact, namely, the inadequate financial contribution of self-insured persons to the pension insurance system. The point at issue here is the fact that regardless of the amount of their incomes, the mass of self-insured persons pay pension insurance based on the minimum insurance income.

Therefore the measures leading to positive effects should envisage reduction and elimination of the negative consequences of the grey economy, a differentiated approach to setting minimum insurance thresholds by occupations for the self-employed, the extension of pension insurance coverage to self-employed people in the agrarian sector, precise definition of the criteria for awarding guaranteed minimum pensions to self-employed persons insured on the basis of the minimum insurance income, higher collection rate etc. Lifting the cap on the maximum level of pensions would lead to increasing the insurance contributions of the self-employed in the high income brackets and thus to extension of the scope of pension insurance to that group of persons too.

Experts are of the opinion that the levels of coverage reflect the quality of the social contract between the insured and the objectives of the social security system. In the words of G.Gillion “*the high levels of coverage depend on the high levels of consensus, which in turn depends on the relationship of the social insurance system with the needs and material conditions of the people it is designed to cover. The possibilities for extension of its scope depend on the good governance and design of the system*”. (Gillion,G., 2005)

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**Bulgarian Industrial Association – Union of Bulgarian Business**

**2. The Government Role as Employer and Retirement Rules for State Employees, Including Special Retirement Criteria for Employees in the System of Defense (Military), Police, etc**

An object of analysis are the retirement rules and procedures for employees in formal employment relationship with bodies and organizations funded from the state budget. With regard to these persons the government performs the functions of social insurance providing employer. In that context the government has all powers and is obliged to meet all obligations proceeding from the relevant statutes relating to its role as insurer.

**Coverage of Insured Persons**

According to the Social Security Code (SSC) the government is obliged to pay social insurance contributions for the employees working in government institutions. These are the following groups of employed persons: workers and employees working in legal employment relations with the relevant state institutions; state employees under the State Employees Act; judges, public prosecutors, investigators, state executive magistrates, registrars and registrar officers, as well as members of the State Judicial Council and inspectors at the Inspectorate to the Supreme Judicial Council; the military under the Law on Defense and Armed Forces in the Republic of Bulgaria, state employees under the Law on the Ministry of Interior and the Punishments and Detention in Remand Law, state employees under the Law on the State Agency for National Security. All these persons are covered by mandatory social insurance for the following insurance contingencies: general illness and maternity, old age and death, employment accidents and occupational disease and unemployment. The social insurance contributions for them are paid from the state budget.

**Contractual Relations**

Government-insured persons have the following contractual relations with the government bodies: a/ they work under employment contracts with the respective state institutions as defined in the Labour Code; b/ they have official legal relationships with the respective government bodies, subject to special laws. These laws are: on state employees working under the State Employees Act; military – the Law on Defense and the Armed Forces of the Republic of Bulgaria; state employees of the Ministry of Interior – the Law on the Ministry of Interior and the Law on Punishments and Detention in Remand; judges, prosecutors, investigators, state executive magistrates, registry judges and court officers, as well as the members of the Supreme Judicial Council and inspectors of the Inspectorate to the Supreme Judicial Council – the Law on Judiciary; state employees of the State Agency for National Security – the Law on the State Agency for National Security.

## **Legal Framework of Social Security and Retirement**

The legal framework of the rules and procedures on providing social insurance and retirement plans for workers and employees in government institutions is set out in the Social Security Code, Art. 4 on the scope and Art. 69 on the terms of pension entitlement. The other problems concerning the right to compensations, advance notice etc. to which one is entitled in case of retirement are settled in compliance with the provisions in the relevant special laws applicable to such relationships.

### **Amount of Insurance Contributions**

The amount of insurance contributions is differentiated for the different groups of people employed in government institutions: a/ the total amount of the insurance contributions made by workers and employees working under legal employment contracts for state social security and health insurance is equivalent to 30.7 per cent of the insurance income of each insured person. The amount covered by the insurer is 17,7 per cent and that by the insured person – 12.9 per cent. The government pays 9.9 percent for pension insurance by the Pension Fund and the insured person - 7,9 per cent. For persons born after 31.12.1959, in accordance of the terms of the adopted three-pillar pension system, 5 per cent of the defined contributions go to a Universal Pension Fund chosen by the person. The distribution of insurance contributions between the employer and the persons is 60/40 percent.; b/ the total amount of insurance contributions under the special legislation is 20,8 percent.

### **Payment Arrangements**

Two options exist for payment of insurance contributions by the workers and employees working for government institutions: a/ workers and employees in legal employment relationships with government institutions pay personal social insurance on their own account from the remuneration received by them; b/ insurance contributions for all state employees and the military are at the expense of the employer and they are centrally paid every month by the Ministry of Finance into the State Social Security Fund (SSSF).

### **Minimum and Maximum Pension**

The amount of the established maximum pension benefit is 700 BGN, or 35 percent of the maximum insurance income. The minimum pension benefit is equal to 136,06 BGN.

### **Terms of Retirement**

Persons working for government institutions are entitled to retirement on old-age pension under two major provisions of the Social Security Code:

- Workers and employees working under employment contracts with the respective government

institutions and state employees retire under the terms defined in Art. 68 of SSC. According to this provision entitlement to a pension for complete length of service and old age is acquired upon reaching the age of 60 for women and 63 for men and qualifying period of 34 years for women and 37 years for men. Starting from 31 December 2020 the age limit will be increased on the first day of each next year by 6 months for women and men till women reach the age of 63 and men reach the age of 65. The law prescribes that starting from 31 December 2011, on the first day of each next year, the insurance years of service limit under paragraph 1 shall be increased by 4 months for women and men until 37 years are completed for women and 40 years – for men. Where no pension entitlement is acquired under the above terms before 31 December 2020, women and men are given such a chance when upon reaching the age of 65, provided they have no less than 15 years of completed actual length of service. The legislator has envisaged higher retirement age starting from 31 December 2020 by raising the age limit by six months on the first day of each calendar year until the age of 67 is reached.

**Pension entitlements for the military under the Law on Defense and the Armed Forces of the Republic of Bulgaria, for the state employees under the Law on the Ministry of Interior and the Law on Punishments and Detentions in Remand and for the investigators are provided in accordance with the provisions of Art. 69 of SSC.** That group of state employees and military receive pension entitlement, regardless of age, upon discharge from service and upon completed years of service as follows: until 31 December 2011 - 25 years total qualifying period, two thirds of which should be actual service in compliance with the provision of the law governing the established legal employment relationships for their service. As far as these persons are concerned, it is envisaged that starting from 31 December 2011 their pension qualifying shall be increased by 4 months on the first day of each next calendar year until 28 years are reached, of which two thirds should be actual service in compliance with the stipulations of the law governing their legal employment relationship.

### **Compensation Entitlements**

**Workers and employees working under employment contracts** have the following **compensation entitlements** in case of retirement: a/ one-month retirement notice; б/ entitlement to a compensation from the employer equal to the amount of the gross remuneration for a period of 2 months and, if one has worked for the same employer over the past 10 years of labour service – a compensation in the amount of one's gross remuneration for a period of 6 months.

- **State employees under the State Employees Act are entitled to the following compensations in case of retirement:** one-month notice; entitlement to a compensation in the amount of as many gross monthly salaries at the time of termination of the employment relationship as years served as a state employee, but no more than 20 salaries. Where by the time of termination of the employment contract the state employee has worked in the same administration during the past 10 years, he/she is entitled to

receive 6 gross monthly salaries, and where he/she has worked less than 10 years – 2 gross monthly salaries, if that arrangement is more favorable for him/her. Compensations are also due when the employment contract is unilaterally terminated by the state employee, or terminated by mutual consent, and at the time of termination he/she has become eligible for a pension for old age and complete qualifying period.

**- Government employees under the Law on the Ministry of Interior and the Law on Punishments and Detention in Remand as well as the military under the Law on Defense and the Armed Forces of the Republic of Bulgaria are entitled to the following compensations:** In case of dismissal the state employees and the military are entitled to a lump cash compensation amounting to as many gross monthly salaries as years served by them, but no more than 20, as well as to a one-time cash benefit. With the military the military service contract can be terminated and the member of the armed forces may be discharged from military service at six-month notice in case of acquired pension entitlements under the terms of Art. 69 of the Social Security Code.

### **Problems Demanding New Solutions**

**- The government as an employer should be equal in status as insurer with all other insurers with regard to its obligations set out in the relevant legislation.** In the current practice the payment of social security contributions takes place every three months through a general transfer for all government institutions carried out by the Ministry of Finance. The legislator requires payment of social insurance contributions for the employees in government institutions on a monthly basis as prescribed in SSC. Moreover, the contributions should be on the account of the budget of the institutions concerned. The introduction of such a practice shall make it possible for government institutions to be penalized under the same procedures as applied to all other employers should they fail to observe the time limits set in SSC. Besides that shall help bringing to light the actual budget spending by the respective government institutions and guarantee equality to all insurers with regard to their obligations.

- State employees should pay individual contributions just as all other people employed in the economy. For the time being those employed in the government administration pay no individual insurance contributions out of the remuneration received by them. That is why in 2010 105.9 million BGN were set aside in the state budget in order to cover the state employees' liabilities as employer contributions. The average insurance income of the state employees is 920 BGN. The introduction of such an arrangement shall have no particular economic effect on the budget, but it shall have a discipline enhancing impact and provide equality for all insured in respect of the social security institutions.

- The actuarial estimates applied to determine the amount of insurance contributions for the military



under the Law on Defense and the Armed Forces of the Republic of Bulgaria, for the state employees under the law on the Ministry of Interior and the Law on Punishments and Detention in Remand as well as for the investigators should be reviewed. The analysis shows that SSSF insurance contribution revenues from these systems are less than the incurred real expenditures for payment of pensions. As of 31.06.2010, according to data of the National Social Security Institute (NSSI) 83180 investigators, military and employees in the judiciary have been insured on the basis of 973 BGN as average income (at 570 BGN average income for the country). At the same time about 93 000 people are expected to benefit from early retirement in 2010 under various special laws. For 2010 the pension expenditures for that group of employees in the country have been planned to reach the amount of 496.5 million BGN. In 2010 the funds set aside in the state budget for insurance contributions for these categories of persons amount to 215.6 million BGN. The resulting deficit of about 280,9 million BGN is to be covered from the contributions of the people in the real sector and from the government-provided subsidy.

That deficit appears as a result of the lower insurance contributions paid for these persons. In 2010 the SSS Pension Fund the contribution rate was equal to 31 per cent, whereas the insurance contribution to cover the payment of pensions to this category of persons is 47.7%. The situation with the other categories of insured persons (magistrates, prosecutors, state employees etc) is similar, with the government paying only about 45 per cent of the required insurance contribution to the Pension Fund. That approach remains the same in 2011.

**- In determining the amount of the pensions for the above mentioned employees it is objectively necessary to assess the impact of a number of factors, such as the pension eligibility age limit , how long the pension benefit has been received etc.** The estimates show that the average amount of pensions received by military, law enforcement officers and some employees in the judiciary system is nearly twice higher than the average pensions for the country. In 2010 the average monthly amount of newly-awarded pensions was 443 BGN whereas the average pension in the country was equal to 262 BGN. The structure of the amount of pensions received as of 31.06.2010 reveals that the largest number of pensioners (16.8 per cent, or 368 521 people) receive basic pensions between 115.68 and 136.08 BGN. Another large percentage (14 per cent. or 307 299) receive pension amounts between 200 and 250 BGN. The pension benefits of nearly 11 per cent are between 300 and 400 BGN, while 9.5 per cent receive pension between 250 and 300 BGN. The maximum pension of 700 BGN is received by 44 416 people.

The analysis of these data shows also that a/ the average age for newly-awarded pensions to persons who have used their entitlement to early retirement under these schemes is 50,8 years, but for the third labour category it is 62 years; b/ a serious disproportion also occurs with regard to the average period

of pensions received: for the military and the law enforcement officers it is 23,9 years, for second labour category workers - 17,8 years and 22,9 years for all others.

For these reasons we think some solid grounds exist and propose the establishment of a fair **minimum retirement age limit** for that group of people, just as with all other insured persons. Such a proposal is also supported by the experts of the International Monetary Fund (IMF). The last IMF mission recommended that the early retirement options for the special labour categories – military and state employees from the system of the Ministry of Interior should be reviewed. It is assumed that the military and the law enforcement officers can retire after 25 years of service, keeping in mind that at least 34 and 37 years are required as a qualifying period in the major labour category.

**- The scope of the persons using their early retirement entitlements should also be reviewed.** Employees who hold administrative and other similar offices in the systems of the Ministry of Interior and the Ministry of Defense, as well as those engaged in services to the population or working in technical and other offices of a general nature should not enjoy any early retirement entitlements; instead, they should be eligible for retirement in compliance with the general procedure. The entitlement and privilege of early retirement should be extended only to those state employees and military who work in conditions of high risk and hazard to their life and health. That will lead to greater justice and equality in the pension system and help lower the spending on pensions and insurance contributions.

In that context the IMF experts recommend a ‘**step-by-step abolition of early retirement for the special categories**’. They believe that the introduction of that practice will lead to the harmonization of the legal framework of public pensions even if the funds saved with the help of such measures do not seem significant. The experts are categorical that the elimination of these privileges would lead to greater justice. Worth noting is also the conclusion that it is not economically justified for certain categories (including the military and the state employees) to benefit from a more favourable legal framework of retirement as compared with the other workers and employees.<sup>1</sup>

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<sup>1</sup> МВФ. Паметна бележка. Реформиране на пенсионната система. октомври. 2010, гл.3 и гл.4.

### 3. The Necessity of Raising the Retirement Age in Bulgaria

The financial and economic crisis has seriously exacerbated the existing problem of population aging. While highlighting the interdependence of the different schemes and revealing the weaknesses of some models, the crisis has rung an alarm signal for all pension systems, whether pay-as-you-go or capital-funded: higher unemployment, weaker economic growth, higher levels of domestic debt and unstable financial markets have generated further difficulties for the pension systems.

The major challenges facing united Europe are clearly defined in the recently published **Green Book** by the European Commission. The continent is confronted with a serious demographic challenge as the first generations born during the post-war boom of the birth rate are now coming close to the retirement age. The population in active age in Europe will begin to shrink after 2012;

- The unprecedented high longevity combined with low birth rate levels will lead to a drastic change in the age structure of the population. As a result the dependence rate will double: while now there are four persons in active age for each person over 65, by 2060 each person over 65 will be matched by only two persons in active age;
- Currently full-time professional life begins later due to the higher need for education and earlier retirement as a consequence of age management and the prevailing policies on the labour market;
- Women are still leaving the labour market long before the traditional retirement age of 65 years, which brings the gender-related aspects to the foreground. With the current trends that situation cannot continue. Unless people who live longer are longer engaged in work, there is a danger of a declining pension adequacy or of an unbridled growth of pension costs. The effect of the demographic changes, reinforced by the crisis, will lead to lower economic growth and a heavier burden on the public finances;
- The age of retirement should be increased so that no more than one third of the time of the elderly should be spent in retirement. If no such reform is made, the Commission envisages the need of lowering the pension size and raising pension insurance contributions;
- The European commission recommends a significantly higher age of retirement in the member countries. Over the 2001-2008 period the average retirement age was raised from 59.9 years in 2001 to 61.4 years in 2008. Before 2020 that level is expected to grow higher since ten of the member states

have already planned to increase the legally established retirement age. Most countries are gradually transitioning to a universal age of retirement of 65 years while others like Great Britain, Germany and Denmark already have provisions in place for further increases.

To overcome the demographic challenge it is necessary to significantly increase the rate of employment and, more specifically, to encourage and help ageing people from the generation of the demographic boom to stay on the labour market instead of retiring as usually done by the previous generations. The best chance for Europe to ensure that the population ageing would not be perceived as a contingency but rather as a historical achievement, is to make sure that the potential of the demographic boom generations are not lost.

### **Prerequisites for and Necessity of Reform in Bulgaria**

As a member of the European Union Bulgaria should respond to the current changes experienced in it . Despite the massive pension reform carried out barely 10 years ago, today we are once again faced with the need of further modernization of the Bulgarian pension system, so that it can respond to the new economic, demographic and social conditions. Let us recall that between 2000 and 2009 the retirement age was raised from 60 to 63 years for men and from 55 to 60 years for women.

- Despite the positive trends reported in recent years in the dynamics of the major demographic development indicators in the country, the process of population ageing in the long run is still underway, which naturally leads to a higher indicator determining the average age of the population. That indicator was 39.9 years in 2000 while in 2005 it was 41,2 years. In 2009 the average age of the population for the country at large was 41,8 years. Its level in the towns is 40,3 and in the villages - 45,5 years;
- All demographic estimates predict intensification of the process of population ageing manifested in a growing relative share of the individuals beyond the active age and of those of middle age in the population. The share of the individuals over and above the active age was 22.4% in 2009, while in 2020 it is expected to reach 30% and in 2060 – 57%;
- As shown by actuarial estimates the spending on state social security funds (SSSF) will be increasingly higher than revenues; thus around 2050 the balance will be negative (-15,5%). The long-term estimates for the next 50 years are pessimistic. The ageing of the population is irreversible. That will put social security under pressure as fewer and fewer workers will have to support more pensioners. The dependence rate (number of pensioners per 100 insured) is 77.5% for 2009. In ten years this ratio is expected to be even more unfavorable – 100 to 69;
- In 2009 28,9% of the population were pensioners and one fourth (over 24%) of the employed were intermittently insured. Consequently if no steps are taken to raise the retirement age, accompanied by

initiatives for employment of aged workers and curtailment of early retirement, that will grow into a threat to both the achievements of the pension reform and the adequacy of the pensions of the current and future retirees.

- The estimates of the National Statistical Institute on the total number of the population in Bulgaria in the next few decades are also pessimistic. It is expected to shrink from 7 528 thousand people in 2010 to 5 475 thousand people in 2060, or by more than 2 000 thousand people;
- The decline in the insurance contributions over the period between 2000 and 2009 did not lead to a higher compliance rate and bringing out more shadow economy in the open. People en mass do not pay insurance contributions based on their real incomes and many work without employment contracts;
- The measures being applied fail to yield the expected effect of adjustment and improvement of the balance of incomes and expenditures.
- The growing insurance contributions and spending on pension without a balance with revenues has led to a growing deficit in the National Social Security Institute (NSSSI) from 472.4 million BGN in 2004 to 1 558.2 million BGN in 2009 and in 2010 it is expected to exceed 2 060 million BGN. The Bulgarian pension insurance system is changing from a social security system into a tax-funded system. Stopping the decline of insurance contributions and their gradual increase backed up by actuarial estimates can revive their role of a major revenue source in the system and strengthen the financial stability. That is only too natural, the more so that pension growth is one of the reasons for the deficit at NSSI.
- Over the past 10 years pensions went up by over 10% a year – more than twice the average growth of the country's economy. Certain specific disproportions appeared in 2008 and 2009. In 2008 the pension expenditures increased by about 20% while the economic growth was in the range of about 6 per cent. Before the elections in 2009 pension expenditures increased by about 16 per cent, while the economy slumped by about 5 per cent. In 2009 the relative share of pension expenditures was close to **10 per cent of GDP** for the first time in ten years.
- In terms of gender equality the gradual rise of the retirement age for women until it is level with that for men is inevitable during the next few decades. Women's earlier retirement compared to men has not proven to be in their interest. With the lower age limit for retirement they find it more difficult to complete the required length of service because of child care or other family duties; furthermore, their wages are lower than those received by men. That is one of the reasons why women's average pensions are statistically lower than men's. The trend in the average individual coefficient of newly-awarded pensions to women (1.083) to be significantly lower than that for men (1.449) is still

preserved and that is reflected in the average size of their pensions.

In the light of the facts and considerations set out above and as a result of the broad public debate held by the end of this year the National Assembly of the Republic of Bulgaria has passed some amendments in the Social Security Code. The main object of the reform is to guarantee long-term financial stability of the Bulgarian pension system and to achieve higher pension adequacy.

As part of the package of measures seeking change in retirement age, length of service and contributions, *starting from 31.12.2020 the retirement age shall be increased from the first day of each next calendar year by 6 months for women and men up to the age of 63 years for women and 65 years for men.*

#### **4. Appropriate (Transparent / Robust / Easily applied) Criteria in Determining Social Insurance Contributions Increases**

The way this topic is worded suggests inevitable rise of social insurance contributions. That however should not be a key objective in improving the operation of the system instead streamlining and finding the right balance in order to overcome the deteriorating deficit over the years, especially in the field of pension insurance. To put it differently, the rise of contributions in itself cannot be the only universal solution, be it only for the fact that the expected balance has not happened in the past years, even though the contributions were much higher (several times).

State social security (especially the so-called first pillar of the pension system) in the Republic of Bulgaria rests on the pay-as-you-go principle. With that model no funds are accumulated in individual accounts, which limit the chances of investing these funds in the course of the insurance period or of income accruing from them. The funds deposited for insurance in the respective year are used to pay off the pensions of the current pensioners. That model presupposes increased number of people paying contributions in order to guarantee the financing of the expenditures for the persons benefiting from their pension entitlements. In other words, the successful operation of the pay-as-you-go principle is directly related to the demographic characteristics of the country: the increased share of young people is a key precondition for success of the model and vice versa – when this share is lower (and the share of the elderly respectively higher) the operation of the system is inevitably deteriorating (especially its financial dimension).

Unfortunately, according to data provided by the National Social Security Institute (NSSI) the demographic situation of the population in Bulgaria points to a lasting trend of growth of the share of the elderly and decline in the relative share of young people. According to data for 2010 the ratio of inactive age persons (over 65 years) and those in active age (15-64 years) is 25 per cent with a tendency of reaching 30 per cent in 2020 and 57 per cent in 2060. On the other hand, the dependence rate as a ratio between the beneficiaries of the social insurance system and the payers of insurance contributions was 77.5 per cent in 2008 and according to the expected data it will be 77.7 per cent in 2010. After the tightening of the pension access criteria mostly by raising the required qualifying period for retirement and limiting the chances for early retirement, the dependence rate is expected to drop to 74.6 percent and, in the longer run, according to actuarial estimates of NSSI and taking into account the development of the demographic trends, the dependence rate is expected to go up to 117.1 per cent by 2060.

These data are an argument in favour of accepting the increase in the years of service and the limits on the scope of early retirement and initiating measures to increase the collection rate and extend the social insurance scope.

Next to that the collection rate defined as a ratio between the insurance contribution receipts in the State Social Security Fund and the funds due from insurance contributions (according to plan) tends to drop. Thus NSSI reported a compliance rate of 111.7 per cent in 2008 while in 2009 the ratio was already down to 86.4 per cent.

On the other hand, some nominal growth of the average pension has been reported compared to the preceding year according to NSSI data, amounting to 16.98 per cent in 2009 vis-à-vis 21.76 per cent in 2008. For pensions funded from SSSF the growth rate in 2009 was 17.1 percent as compared to 2008.

The negative effect of the informal economy upon the collection rate and the amount of the insurance contributions cannot be denied. By NSSI data again the ratio of insured and employed persons was 76.1 per cent in 2009 and 74.34 in 2008. These facts show that no less than one fourth of the employed are not insured and if those who do not make contributions based on real incomes are added to that number, we are able to draw some relevant conclusions concerning the share of the informal economy. In that context one should also consider the indirect positive effect of the amount of the minimal insurance income set every year by key economic activities and occupational qualification groups as a means to limit the grey sector, on the payment of contributions based on real (or close to real) incomes. It is precisely here that reserves can be sought in the NSSI funds rather than increasing the amount of contributions, which will further narrow down the base of revenues and generate more informal economy.

In short, the relative share of persons with pension entitlement (pensioners) and the pensions size (nominal and real) are currently growing while the contributions compliance rate is declining. One cannot but note that the growing size of pensions will lead to an even lower compliance rate and exacerbation of the problems instead of working towards their overcoming. Furthermore, considering the principle of the solidarity on which the system is based and the permitted co-financing over and above the individual contribution for persons requiring equalization up to the minimum level of pensions for complete qualification period and old age, this practice not only does not rest on real contribution (in violation of the principle already adopted), but is also damaging and de-motivating for those who have to add to the payments that have not been made by other eligible persons. It should be noted here that as of 31.12.2009 the persons receiving minimum pensions accounted for 23.2 per cent of all pensioners and those entitled to a maximum limited pension – for 1.95 per cent.

The issues raised so far do not lead to a conclusion that the contribution growth will solve the problems of the social security system and, in particular, those of the pension insurance system. It is



not accidental that at the time of adoption and establishment of the current model the contribution size was almost twice higher than the current one, but then NSSI was operating in conditions of deficit. Therefore accepting the high level of contributions as an absolute necessity is not a panacea and will not resolve problems that have been piling up and aggravating over the years. A balanced solution should be sought simultaneously along two major lines: increased receipts and limited costs.

The first priority in increasing revenues should be to extend the base (the number of persons) paying insurance contributions rather than increasing the contribution size, which would in turn lead to further contraction of the base and formation of a spiral along the lines of a negative trend in the absolute amount of returns. In other words – more payers and more affordable contributions. Along with the other effects of the social security system that approach is most favourable for the economy and competitiveness and, in general, for job retention and job openings/containment of unemployment, for the reduction of the informal economy and, last but not least, for countering the trend towards insisting on a higher price for performance deviating from the established rules and accompanied by the risk of sanctions. In that context one should continue the practice of annual negotiations of the level of the minimum insurance income (MII) by key economic activities and occupational qualification groups while keeping up the trend of gradual increase, in compliance with some objective criteria, of the minimum insurance income (MII) on an annual basis. One should keep in mind the favourable impact of this increase both upon the share of the informal economy and upon the insurance contributions revenues (even in the period of recession the growth of MII in the agreements on certain economic activities reached 21.8 per cent for 2010 as against 2009 , at an average growth of 6.06%).

A positive effect along these lines is also exerted through the employer's obligation introduced since 2003 to notify the competent territorial directorate of the National Revenue Agency whenever employment contracts are signed, modified or terminated. In addition of bringing some concealed employment relations "in the open", that practice would encourage the rise in the number of persons contributing to the social security system.

Next to the higher length of service required, another measure aimed at the targeted result, i.e. more substantial contribution in terms of time and finances, could be sought in a gradual leveling of the required retirement age limit for men and women. The past practice shows that the required lower age limit for retirement for women is largely detrimental, due to the shorter length of service and lower revenues from contributions leading to entitlement to lower pensions.

Another reserve to raise receipts can be the accurate determination of the contributions for self-insured persons. Insurance contributions due from self-insured persons are calculated on the basis of the chosen social insurance income within the range of the minimum and maximum social security income, the levels for self-insured persons being determined annually with the Law on the Budget of

State Social Security. Since 2010 the minimum insurance income has been made higher for self-insured people from 260 BGN to 420 BGN/month and for registered agricultural and tobacco producers – from 130 to 240 BGN respectively. Some existing allowances for lower insurance levels have been removed. A minimum monthly insurance income differentiated in four steps was adopted in 2011 for self-insured persons based on their taxable income in 2009. That objective, clearly defined criterion of using the income in the preceding year as a base, is a step forward in the right direction. There are some currently unused resources in that area for increasing contributions through insurance by analogue, i.e. the same activity – the same contribution size, moving towards higher levels, with the base being determined by the actually declared incomes for the respective activity in the preceding year.

Also taken into account should be the positive impact of the government's involvement as insurer through transfers from the state budget amounting to 12 per cent of the total amount of insurance incomes for all insured persons in the relevant calendar year. In searching for fund increases the stake should be put here precisely: increasing the share of the state within reasonable limits. Not least, the potential effect from the future splitting of the workers and employees' insurance contributions between insurers and insured in the ratio of 50/50 should also be taken into consideration. That was indeed the intention at the start of the present state social security model.

The increase of revenues taken itself cannot resolve all problems if it is not examined in a package with cost reduction. It should be made very clear that what is meant here is a set of measures and not incidental changes with limited effect on the pension system in terms of time and resources. It is necessary to re-examine the causes and possibilities for limiting the “leakages” in the NSSI system and to develop effective methodologies of prevention and ongoing control, including statutory solutions for a precise definition of:

- access to invalidity pensions;
- payment of sick leaves;
- acquiring early retirement entitlement;
- Children's allowances granted to families with many children.

In terms of percentages the amount of disability pensions and the sick leaves funds granted in the country is not logically consistent with those in the European countries with similar characteristics. On the other hand, in its early retirement part the system is additionally burdened by the failure to pay in full the mandatory contributions for entitled persons and, respectively, by their inadequate contribution to the social security system, which results in a broken link between contributions and the entitlements received.

Although one cannot share the concept of fully capital-funded pension system, the higher level of

capital at the expense of the pay-as-you-go principle is an appropriate trend. The mandatory supplementary insurance applicable to people born after 31.12.1959 takes the form of insurance in private pension funds in individual accounts with funds accruing, which will appear as sources for receiving a second pension. The expected pension benefits from a private fund and from the government system will be different and the difference will be in favour of the private funds. According to the National Social Security Institute the correlation between a pension from the government fund and the insurance income will be lower over the next years to come. That is an incentive for a smooth, balanced growth of the share of the capital-funded system by limiting the amount of state insurance and encouraging growth in the share of the capital-funded pillar.

In conclusion, the accent should be placed on a greater independence of the State Fund guaranteeing the sustainability of the state pension system (the so-called “Silver Fund) and on initiating statutory changes to remove the ban on investments, especially in shares of companies registered on the territory of the country as well as in derivative instruments related to them, which, in addition to anything else, will also stimulate the development of the national economy. The better operational capacity the Fund’s independence (and the structuring of its governance on a parity basis) may generate additional revenues and additional fund transfers to the budget for the Pension Fund.

## 5. Pension Insurance Differentiation by Sectors

This paper presents the differentiation of pension insurance in harmony with the structure of the pension system, the structure of the insured and the pension funds in the system of state social security.

### Differentiation within the Framework of the Pension System

The Social Security Code (SSC) regulates the principles, scope, functions and institutional services to the three pillars of the pension system in Bulgaria. The first pillar is the mandatory pension insurance as part of state social security (SSS) and it is handled by the National Social Security Institute (NSSI). The second pillar is the supplementary mandatory pension insurance in universal funds for persons born after 31.12.1959 and insurance in occupational funds without age limits. The third pillar is the supplementary voluntary pension insurance provided in two kinds of funds: funds for supplementary voluntary pension insurance and funds for supplementary voluntary pension insurance in occupational schemes. The funds in the second and third pillar are run by private pension insurance companies whose activities are regulated in the SSC and supervised by the government Financial Supervision Commission. Following the legislative changes by the end of 2010 the occupational funds of the supplementary mandatory pension insurance were fully transferred to state social security. While the first pillar rests on the pay-as-you-go principle, the second and third pillars are based on the individual contribution of the insured persons and the pensions schemes are developed on the capital-funded principle. The first pillar is the really operating element of the pension system with a revenue and expenditures part, while the supplementary mandatory pension insurance in the universal and occupational funds accumulates funds which will be spent after 2015 and 2012 respectively.

In 2009 the scope of each of the three pillars was as follows:

- **First pillar** - 2 829 819 persons, or 59,3% of the population in active age. All economically active persons are obliged to insure themselves.
- **Second pillar** - 3 114 873 persons, or 65,2% of the population in active age. These numbers are divided between the universal and occupational funds - 2 890 000 persons (60,5%) and 224 873 (4,1%) respectively. Covered in the universal funds for a supplementary second pension are all persons born after 31.12.1959 and insured in the funds of the first pillar. Insured in the occupational funds for an early retirement pension are workers and employees in the 1<sup>st</sup> and 2<sup>nd</sup> work category (heavy and hazardous conditions of work), irrespective of their age.

- **Third pillar** - 605 106 persons, or only 12,7% of the population in active age; among them 4 641 persons (1%) have been insured in funds for supplementary voluntary pension insurance under occupational schemes.

The points scoring system of determining pension eligibility based on years of service and old age has been eliminated starting from 2011. According to the new criteria women have to be 60 years and men – 65 years of age and to have 34 and 37 years of length of service in order to be eligible for a pension. SSC regulates the calculation of the length of service by occupations, with one year length of service for insurance purposes in the 1<sup>st</sup> labour category being equal to 3 years of service in the 3<sup>rd</sup> labour category.

The minimum insurance income is set in the Law on the State Social Security Budget both by categories of occupations and by contributions rate. In 2011 *insurance contributions for pensions for old age and length of service were raised* by 1,8% as compared to 2010. For persons born before 1.1.1960 the insurance contribution is 17,8% for workers and employees in the 3<sup>rd</sup> category of work and 20,8% for persons working in the 1<sup>st</sup> and 2<sup>nd</sup> category of work. The contribution for persons born after 31.12.1959 is 12,8% for the 3<sup>rd</sup> labour category and 15,8% for the 1<sup>st</sup> and 2<sup>nd</sup> labour category. With the mandatory pension insurance the contributions are divided between the employer and the worker/employee and with the self-insured they are fully at their expense. The contributions for supplementary mandatory pension insurance in occupational funds are fully on the employers' account. According to estimates of NSSI experts about 28% of the employees in the private sector pay insurance contributions based on the minimum insurance income.

### **Differentiation of Persons Insured in the State Social Security**

The structure of those insured in SSS is made up of two major groups: those insured by an employer/contracting authority and self-insured persons, accounting for 90,7% and 9,3% respectively. Covered by employer/contracting authority are those working under employment contracts, state employees, persons insured against disability, old age and death, those working without any employment relationships and persons enrolled in insurance programmes. *Those working under legal employment relationships* account for 84% of all persons insured in SSS (Figure 1). They are divided between the three labour categories, with 3<sup>rd</sup> labour category workers and employees accounting for 80% (2 260 246 people) of the persons insured in SSS. Workers and employees in the 2<sup>nd</sup> labour category number 106 052, or 3,7%. Insured in the 3<sup>rd</sup> labour category in SSS are 7 759 workers and employees, or barely 0,3%.

*State employees* are 137 387 people, or 5% of the persons covered in SSS. The group of persons insured against disability, old age and death (22 965 people) and those insured on other grounds

(32 031 people) participate with 1% each in the structure of SSS insured persons (Fig. 1). The group of *insured on other grounds* includes working people in cooperatives without employment contracts and persons included in social insurance programmes.

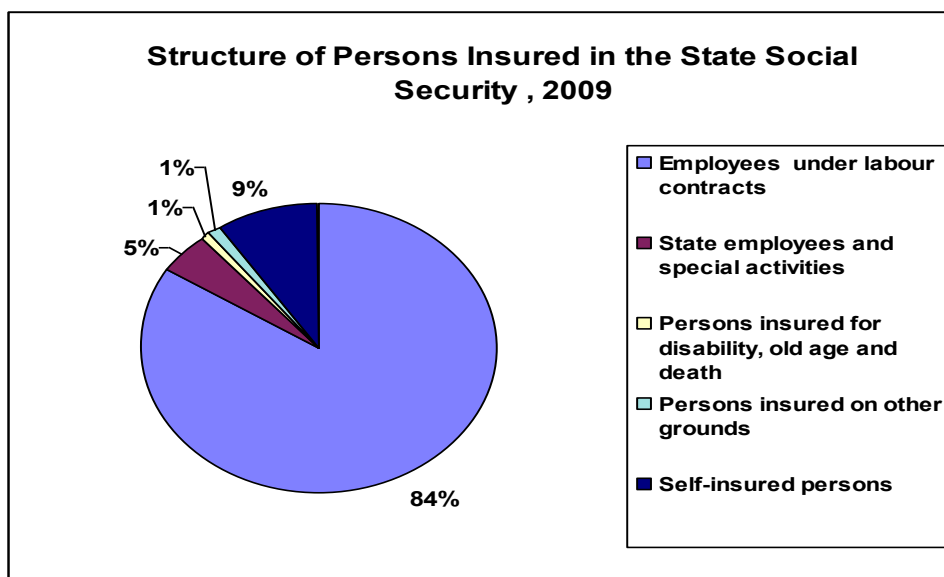


Figure 1. Structure of persons insured in the state social security. Data source: NSSI

Significant differentiation is observed in the average monthly insurance income by groups and categories of insured persons (Fig.2). In the group of persons working under labour contracts those working in the 3<sup>rd</sup> labour category have the lowest average monthly insurance income of 525.00 BGN. Persons in the 2<sup>nd</sup> category are insured on the basis of 713,00 BGN, and in the 1<sup>st</sup> category - of 900,00 BGN.

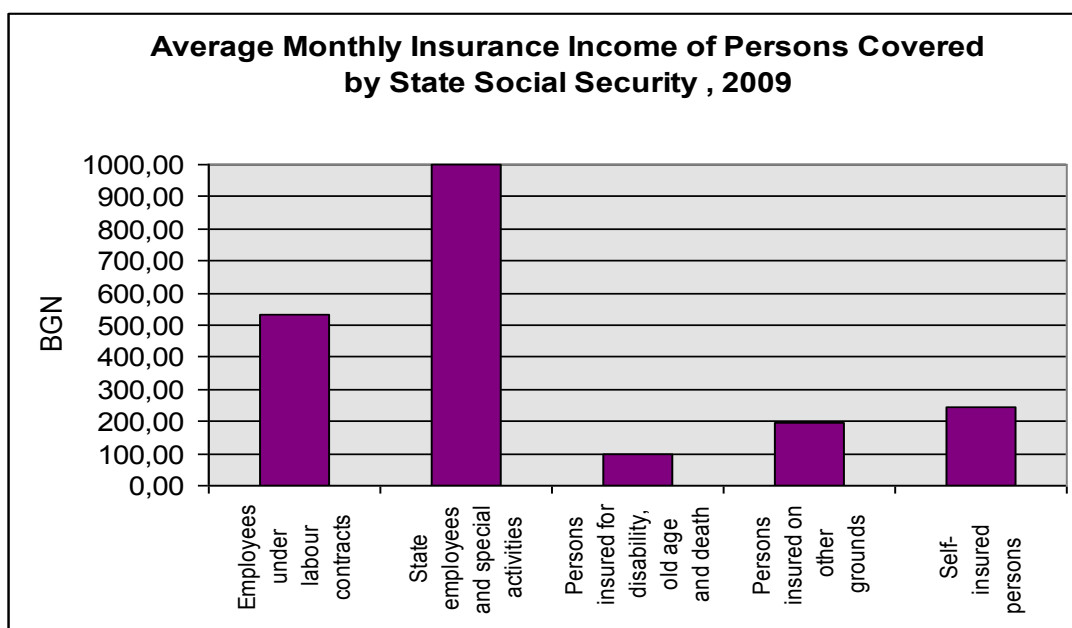


Figure 2. Average monthly insurance income of persons covered by SSS. Data source: NSSI

## **Differentiation along the Line of the Pension Funds in the State Pension Insurance System**

The mandatory pension insurance in SSS is run by the Pension Fund. According to NSSI data for 2009 58% of the revenues and transfers to the Pension Fund come from insurance contributions (2 824,2 thousand BGN). The revenues from insurance contributions have the following structure: 56,3% from insurance contributions paid by the employer/contracting authority; 36,7% from personal insurance; 5,3% from contributions of self-insured persons; 1,7% - other. Pension expenditures in the structure of the total expenditures of the Pension Fund amount to 99,98% (6193,7 thousand BGN.), those at the expense of SSS accounting for 98,6%. The structure of pension expenditures from the Fund is as follows: -75,8% - pensions for length of service and old age; labour service pensions in case of disability and general illness - 16,7%; and service pensions and invalidity pensions for military employees - 7,5%.

Another public pension fund is the Teacher Pension Fund (TPF) where 91 968 persons are insured (2009), working in the sphere of education – kindergartens, schools and auxiliary units. The average monthly insurance income is 721,00 BGN. (higher by 165,00 BGN than the average monthly insurance income of insured persons with contributions to state social security). The insurance contributions come up to 82% of the total revenues of the Fund, that amount being 26 points higher than the share of insurance contributions in the receipts of the Pension Fund. Pension expenditures account for 64.5% of the TPF expenditures and expenditures on allowances- 34,4%.

NSSI also runs the Fund for Pensions Not Related to Labour Activity (pension for war invalids, civil invalids, social old age pensions) which is financed from the state budget.

The updating of the legal framework related to the pension insurance system over the past few years is focused on improving the balance and sustainability of its structures. Bulgaria allocates 7,3% of its GDP for pensions – much less than the average EU level – 11.8% (2009). Among the main factors for the exacerbated financial condition of the pension system are the deteriorating demographic structure, the large portion of the grey economy and the low incomes. The measures adopted by the end of 2010 are expected to would have a stabilizing effect on the pensions system.

### **Literature**

\*\*\*Law on the State Social Security Budget, 2010

\*\*\*Social Security Code, 2009

\*\*\*Social Security in Bulgaria in 2009, NSSI

## **6. Impact of Higher Contributions on Unemployment Growth and Consequent Public Insurance Scheme Changes**

In view of their importance for an ever growing part of the population in the separate countries, the public attention is focused on the issues related to the pension insurance system, its status and development and the need to initiate bolder measures for its reform. The governments of the EU-members countries are faced with the challenge of developing and implementing measures targeted both on the implementation of the common European priorities and on addressing some issues that are specific for the national pension systems.

The crisis has acted as a catalyst of the need of initiating some important coordinated measures for reform of the pension insurance systems, defined over time and financially secured, or of undertaking more radical steps in their operation both at present and in the future. Each EU-member country is confronted with the necessity of an in-depth analysis of its pension system, defining the most important trends and key priorities of the pension reform over so as to be able to respond to the serious challenges arising under the impact of the demographic, economic and social factors

The pension reforms in the individual EU-member countries often imply addressing issues of growing importance under the impact of the world financial and economic crisis, developing new policies and legislative changes for development and upgrading the pension insurance systems, arising from the Europe 2020 Strategy. The importance of the pension reforms affecting, in one degree or another, the functioning of the whole pension system or its individual aspects is even greater in the light of:

- the need to overcome the effects of the crisis on the incomes of the population at large, and particularly of the pensioners. This problem is exceptionally important in Bulgaria owing to the fact that the levels of two of the poverty assessment indicators – percent of the population at risk of living in poverty or exclusion (42%) and persons at risk of poverty after social transfers (41.9%) are both highest as compared to the other EU member-states and significantly higher than the average percentage valid for EU – 23.1% and 8.1 respectively;

- the serious ageing of the population in all European countries and the sustained trend of growth of the population in pensionable age. This problem is even more serious in Bulgaria as a country with the heaviest pension burden and most pronounced trend of ageing. Also deteriorating is the insured/beneficiaries ratio (77,7% for 2010, forecasted level of 117,1% for 2060) as well as the demographic burden rate which is expected to rise from 25.3% (2010) to 63.5% in 2060 – one of the highest levels in Europe;



- The grave problems of the public pension insurance system in most of the EU-member states in terms of its financial stability will deteriorate still further as a result of the current demographic processes and their future exacerbation. The necessity of public expenditures growth as a result of these processes will have to be met in conditions of enforced budget constraints and stringent financial regulations within EU in connection with the steps undertaken for stabilizing the economy of the member countries. That is a serious problem for Bulgaria too in the conditions of a rising pension expenditures rate (8.4% in 2008, 9.8% in 2009). And the anticipated trend till 2060 (11.3%) which will place the country among those with the highest values of that indicator within the frames of EU;
- The attainment of the objective of adequate pensions, the growth of the replacement rate and the resulting increase of the pension funds as a percent of the public expenditures.

### **Insurance Contributions and Insurance Base: Legislative Changes**

One of the four major objectives of the pension reform started in 2000 was attaining financial sustainability of the public insurance funds and containing the growing deficit of the pension system over time. The legislative changes adopted with the Mandatory Social Insurance Code (MSIC) and consequently with the Social Security Code (SSC), including the introduced insurance contributions for the first and second pension pillar and their modification in the period up to 2007 on the basis of actuarial estimates, envisaged elimination of the deficit in the pension system and achievement of positive outcomes after 2006-2007.

Thus as of 01.01.2000 the size of insurance contributions was modified as follows: for the first labour category – from 54 to 38.7% for the second labour category – from 47 to 37.7% and for the third labour category – from 39% to 35.7%. With the establishment of the second pillar of the pension system – the supplementary mandatory insurance in occupational funds for the first and second labour category workers the size of insurance contributions was set as follows: 12 per cent for the first labour category and 7 per cent for the second labour category. These insurance contributions levels are still effective at present.

Unfortunately, in the period up to the end of 2010 the legislative changes introducing changes in the insurance contributions were an outcome of political decisions seeking to achieve results as fast as possible, rather than of any actuarial estimates. Nonetheless they led to grave adverse consequences for the future development of the pension system. As a result of these decisions the contributions to the Pension Fund are lower by 14 percentage points as compared to 2000 and the start of the pension reform. The insurance contribution size was reduced by 3 percentage points as far back as since 01.01.2001. Since 2002, at the inception of the of the universal pension funds as an element of the second pillar of the pension system, two percentage points of the insurance contributions to the

Pension Fund for persons born after 31.12.1959 were directed towards the respective funds and the persons insured in them on the ground of either personal choice or automatic allocation. In 2004, as a result of the increased contribution to UOF from 2 to 3 per cent, the amount of the contributions of persons insured in universal funds to the Pension Fund was lowered by 1 percentage points. In 2005 the amount of the insurance contributions to the Pension Fund was further reduced by 6 percentage points for all insured, the reduction for those insured in UOF being 7 percentage points due to the contribution increase from 3 to 4 per cent.

On 01.01.2007 as the contributions to UPF rose by 5 percent, the contributions to the Pension Fund were lowered by 1 percentage point for those insured in these funds and since 1 October the same year the contribution for all insured persons was further reduced by 1 percent. Since January 2010 the contributions to the Pension Fund were further reduced by other 2 percent down to 16% for third labour category workers.

In the national agreement signed between the government and the representative employers and trade union organization for a new financial stabilization strategy for MSIS and improved pension legislation a contribution increase by 1.8 percentage points was agreed upon, starting from 01.01.2011, and as a result its level was set at 17.8% for the third labour category. It provides for higher insurance contributions to UPF from 5 to 7 per cent in 2017.

With regard to the self-insured persons the contributions to the Pension Fund were equalized with those of the employed persons starting from 01.01.2000 and from 32 they were lowered to 22 percent. The said alterations in the amount of the contributions to the Pension Fund over the period since 2000 also apply to the category of people paying the full amount of the contributions on their own account.

Meanwhile some additional concessions were introduced for some categories as a result of political decisions rather than from well-justified estimates. Some concessions were introduced for the registered agricultural and tobacco producers since 01.01.2001 – payment of contributions based on  $\frac{1}{4}$  of the minimum insurance income.

The serious rise of the deficit in the pension system compelled the government to join the Pension Fund as a special insurer on 01.01.2009 and pay out a contribution amounting to 12 percent of the insurance income of all insured persons, including the self-insured.

As far as the supplementary voluntary pension insurance is concerned, the amounts of the contributions are largely determined by the available tax concessions for employers' contributions and for the individual contributions on the account of the insured persons. As regards the employers' contributions, the tax concessions regulated in the Corporate Tax Act amounted to 40 BGN for each

insured person prior to 2007, including the contributions for supplementary health insurance and life insurance. In 2007 this amount was increased to 60 BGN/month.

As for the individual contributions to SVPI, after a period of early changes in the taxation regime, they are currently set at 10 per cent of the insurance income since 2007, having developed from tax concessions for the entire amount of the contribution to SVPI to different percentages of the insurance income.

An important feature of the legislative regulation of the insurance contributions to the Pension Fund and UPF is the determination and modification of the insurer/insured ratio as an obligation for their payment. At first the percentage ratio and its alteration through the years was regulated in MSIC and eventually in SSC and it was expected to reach 50:50 in 2007. Mostly as a result political decisions and of its annual regulation in the SSS Budget Act the percentage change was adjusted by preserving its level over a longer period of time. From 80:20 at the inception of the pension reform, the percentage value of the insurer/insured ratio is currently 60:40 since 2008.

The revenues in the Pension Fund depend both on the defined insurance contributions set in the relevant law and on the insurance base, i.e. the income taken as a base in their calculation. The following are defined every year with the State Social Security Budget Act:

Maximum monthly insurance income as a base on which relevant contributions are due, which has been set at 2000 BGN since 2008.

Minimum monthly insurance income of self-employed in the calendar year – 420 BGN since 2010 and the SSS Budget Act for 2011 envisages introduction of a differentiated minimum insurance income depending on the incomes received by the self-insured persons;

Minimum monthly insurance income for the calendar year by key economic activities and occupational qualification groups (the so called minimum insurance thresholds);

A serious problem directly related to the changes in the insurance contribution rates is the level of the collection rate. There is a clearly manifested adverse process of the collection rate dropping by 13.6% from 111.7% in 2008 to 86.4% in 2009. That significant decline is an evidence of weaknesses and shortcomings in the collection of insurance contributions due as one of the most important area for the measures for curtailing the financial deficit of the system.

### **Financial Sustainability of the System of Pension Insurance and Alterations of Revenues and Expenditures**

The decline in the economic activity and the GDP growth rates, the falling employment and sharp rise

of unemployment as a result of the financial and economic recession put the financial stability of the public pay-as-you-go pension system under serious threat. Moreover, with the lower insurance contribution receipts following production and staff downsizing the existing deficits in these systems intensified, making the implementation of the policies and measures for their financial stabilization even more difficult. The grave problems in the revenue part of the pension systems are accompanied by processes exerting pressure for significant growth of spending, mostly by means of resorting to legal forms of early retirement and intensified pressure for extension of its scope and significant growth of disability pensions as a form of providing incomes to persons not meeting the eligibility conditions for years of service and old age, etc. That poses additional threats to the financial stability of the system of social and pension insurance.

As a result of the legislative changes after 2000 concerning insurance contributions and pension payments, the revenues from contributions to the Pension Fund have grown by 68.8% over a period of 10 years while the pension expenditures have risen 2.1 times. Thus the shortage of funds over the same period has swollen nearly 23 times. The revenues from insurance contributions cover an increasingly smaller part of the spending on pensions (from 97% in 2000 down to 63% in 2008). The deteriorating mismatch and disproportion between the revenue and expenditure parts of the first solidarity pillar of the pension system are the reason for the financing of the public pension system being increasingly dependent on subsidies from the state budget to cover the deficits (1 523 million BGN for 2009 and 2 062 million BGN for 2010). The growing financial dependence of the SSS Pension Fund on the state budget has deformed the character of the system from an insurance-based system to one financed from tax revenues, which calls for urgent measures both its parts of revenues and expenditures.

The objective envisaged in Europe 2020 for long-term stability of the public finances with a growing percentage of pension expenditures and spending on other social payments is a serious challenge before the European countries against the background of the enforced European constraints on balance budgets and deficits not exceeding 3% of GDP in the individual countries.

The question arises how to achieve balanced budgets in a situation when the pension funds need to grow because of the intensive ageing of the population, growing number of pensioners, higher pension levels and longer periods of receiving pensions.

In that connection, if the contribution rate must be raised as shown by actuarial estimates, that should happen gradually and start with lower percentages, and not as with the erroneous practices now of significant change by several percentage points every year. The measures for limiting the deficits of the public pension system should in all cases be accompanied by adequate statutory amendments concerning the pension payments, introducing stricter eligibility criteria, strict implementation of the

principle of correspondence between insurance contribution and insurance payment, etc.

The rise of pension insurance rates should be considered from the positions of influence and the positive effects for the different pillars of the pension system and in that light it can be assessed differently. The higher level of the contributions to the first solidarity pillar of the pension system, the SSS Pension Fund, should also be considered as a possible measure to reduce the deficit of the public pension system. Moreover, the effect of its operation should be limited in the shorter run and the decision in favour of such a step should be taken very carefully and after an in-depth analysis of the possible effects, especially on the labour market and its development.

The increased level of the contributions to the second pillar of the pension system based on a capital-funded principle, i.e. supplementary mandatory pension insurance, opens up possibilities for accumulation of more funds in the individual accounts of the insured persons and, on that basis, for ensuring higher pension payment levels and, accordingly, for achieving a higher earned incomes replacement rate. From that perspective one should estimate how far these levels contribute to the attainment of the replacement rate envisaged at the start of the pension reform and how they should be altered on the basis of the actuarial estimates. Unfortunately that aspect of the approach to the contributions to the capital-funded pillars has been disregarded because of the focus on limiting the deficits in the first pillar. Hence the limited rise of the contributions to UPF scheduled to occur far in the future, starting from 2017, and the retention of the existing tax concessions for the supplementary voluntary pension insurance.

The decisions referring to the revenue part of the system affect both the size of the insurance contributions and the insurance income as a base for their definition, i.e. the minimum insurance thresholds and the maximum insurance income.

The issue of higher insurance contribution rates should be addressed both for the whole system in terms of its separate pillars. Keeping in mind that capital-funded schemes will account for an ever larger part of the pension size, the need arises for their gradual rise over time in accordance with the regulations.

In changing the insurance contributions size over time one should increasingly take into account the period of pension payments. NSSI data show a clearly pronounced trend toward increase of the average period of receiving pension benefits: –from 16,6 years (1992) to 19,6 years (2008), observed both for men (from 14,1 to 17,1 years) and for women (from 19,6 to 22,2 years). Hence the need for participation in the insurance system on the basis of payment of defined insurance contributions over a certain period of time to be tied up with the expectations concerning the period of receiving a pension as one of the essential factors in making decisions on legislative change.

The growing insurance contributions rate is also linked with a corresponding rise of the insurance payments that may lead to serious financial problems of the system in the medium range. Hence the decisions on raising the contribution amount should always be made on the basis of accurate actuarial estimates and analysis of the social and economic realities, evaluating their economic, financial and social effectiveness.

The above requirement applies most of all to the categories with a privileged regime of retirement: state employees, employees in the system of MI and MoD, in the judiciary system, and first and second labour category workers and employees eligible for early retirement, where the existing gaps between real insurance contribution and the amount of pension payments are biggest.

The demands to attain financial stability and sustainability of the pension systems determine the need for applying an integrated approach, i.e. measures to streamline the revenues and expenditures of the system while seeking efficient solutions to achieve a balance between them. Along with that the reform and development of the pension system demands further steps ensuring better functioning of its separate pillars.

In a situation when as a result of the world financial and economic crisis the existing negative trends and problems of the public solidarity pension systems have deepened and their financial stability and sustainability are under serious threat, the necessity of developing the capital-funded pension systems is increasingly growing in importance. The main lines along which one can and should consider the supplementary pension insurance opportunities are to be found in their potential for providing supplementary income and for increasing the level of pension payments as a means to help alleviate the pressures on and expectations from the solidarity-based public pension system.

### **The Pension System and the Labour Market**

In examining the insurance contributions increase as an instrument for reducing the deficits in the public pension system one should appreciate the possible effects on the labour market and its development.

The problems of the labour market directly impact the financial sustainability of the pension insurance system. The rising unemployment rate and the stalled remuneration levels (as well as the average insurance income as a base to calculate the insurance contribution rates for the separate SSS Funds) limit the revenues both in the public pension system and in the second capital-funded pillar.

At the same time the spending on payment of pensions, compensations and benefits remains at a rather high level and leads to serious deficits covered by the state budget. That necessitates a search of solutions having a quick effect of limiting the deficit in the public pension system and addressing the

financial problems in the short- and medium range.

Particularly negative is the rise of the insurance contributions in a period of crisis and financial stabilization. Keeping in mind that the recovery of the labour markets is a process that follows that of the financial and economic stabilization, increased insurance contributions may lead to a slowdown in the pace of growth of employment. That is the reason why most EU-member countries resort to lower contributions as one of the key anti-crisis measures to reduce unemployment and retain the existing jobs.

The potential of higher contributions in a situation when the national economy that is yet to overcome the effects of the global financial and economic crisis is limited due to objective reasons. Such changes pile up additional financial burdens in a period when the system is fighting for survival and lead to a rapid rise of the unemployment rate and expansion in the scope of the grey sector. That applies especially to a large number of small and medium-size companies and can be reflected in an accelerated process of bankruptcies and substantial growth of the number of both registered and discouraged unemployed. Financial difficulties are most frequently eliminated by dismissing some employed people or through reduced working time and labour pay. In turn that is associated with a further aggravation of the already existing problems of seriously declining contribution revenues and collection rate. While influencing the rising unemployment rate, the positive short-term effect of such a measure may be accompanied by long-range negative manifestations. From that perspective any decisions along these lines may lead to even bigger problems on the unstable labour market, especially in sectors and activities most affected by the crisis, and to a further rise of the unemployment rate, high as it is now. In a situation of crisis and current financial difficulties there is a direct link and relationship between the rise of the insurance contributions and the falling compliance rate

The current labour market situation in Bulgaria puts the country in the group of countries which have failed to successfully tackle the serious decline of employment. The process of dropping unemployment rate down to the lowest level of 6,31% in 2008 was, as a result of the crisis, reversed to a sharp rise up to 9,13% by the end of 2009 and 10,27% by 30.11.2010) (according to Eurostat data). Moreover, according to the expert estimates of some employer and trade union organizations, its level is significantly higher due hidden unemployment, currently reaching over 15-16%. Meanwhile the trend of growing unemployment amongst youths up to 29 years of age has a grave negative effect on the pension system since that is the group with the most significant role in the achievement of financial stability of the system in the future.

Another problem related to the labour market which may have an adverse impact on the financial status of the Bulgarian pension system in the medium and longer term, yet fails to draw adequate attention, is the large number of Bulgarian émigrés working in EU-member countries, especially those

working under no formal employment contracts. That contingent will form a group of people receiving minimum payments from the public pension system, or social pensions. Therefore clearing the pension system of payments of social nature and paying the actual amount of pensions to those qualifying for pensions for old age and completed years of service are of particular importance for its financial stability.

The increase of the insurance contribution rates as a measure of limiting the financial deficit of the pension system in the short run may be directly reflected in declining job opening and lagging behind in the pace of economic recovery and stabilization of the labour market.

### **Changes in the Social Security Systems**

In Bulgaria the deformities accumulating over the past few years after some political decisions on changes in the social insurance legislation, disrupting the financial estimates and leading to a growing deficit have determined the key emphasis on measures to address the problems of the public pension system. The most important debates and steps taken have been one-sidedly focused only on the first pillar and only on some of its separate elements. There is no consistency in the decisions, measures or legislative changes, both as a whole and in respect of each one of the pillar of the pension system. In the emerging situation the problems of the first pillar are practically not only not addressed, but it is also possible that the functioning of the two other two capital-funded pillars would be pulled back and the resulting conditions would generate further new problems in the pension system.

In the aftermath of some political decisions the lack of trust in the solidarity-based pension system may be transferred to the other two pillars too. The negative effects of the inadequate measures over the 10-year period have been intensified with the economic crisis and the risk of failure in fulfilling the objectives of the pension reform has grown.

Each political decision for changes in the system of pension insurance should be assessed from the standpoint of its effect on the functioning of the system not only in the short run, but also in terms of the public expectations. The pension system is rather conservative and the effect of certain political decisions may manifest itself in positive or negative developments for years to come. Hence the need of basing the decisions for legislative change on systematically conducted detailed actuarial estimates and assessment of their impact on the trends and condition of the labour market.

Bulgaria is faced with the challenge of securing a sizable growth of funds necessary to pay out a growing number of pensions over a longer period while adhering to the European requirements for stringent budget discipline and limited growth of public spending. On top of that solutions have to be sought in a situation when the national economy has not been stabilized and the levels of the key economic indicators from the period before the crisis have not been reached yet, i.e. GDP growth,



level of employment, unemployment rate. The situation is complicated by the presence of serious problems on the labour market, high unemployment indicators and limited new job openings. Under these conditions one should seek effective solutions for countering the negative effect of the present crisis in the sustainable balance of public and private insurance

At the present stage in Bulgaria it is important to clearly define the propositions that follow as a matter of principle and in view of their strategic nature and vital importance they should be given political support and responsibility for their implementation. They are directly reflected in the direction of continued development of each pillar of the Bulgarian pension system.

### **New Pension Reform or Continuation of the Year 2000 Reform**

The pension reform launched in 2000 had clearly defined objectives, parameters and expectations concerning the model adopted. Any serious changes described as reform or continuation of reform require clearly formulated goals and logically tied up and financially calculated measures for their implementation in the short and long run. Thus it is necessary that the steps taken towards change of the pension system have a clearly defined goal: stabilization and improved operation of the established model, or more far-reaching changes in the philosophy and in the new model. Yet at this stage there is still no clarity and no political decisions on these strategic issues of importance for the future of the pension system.

### **Unified Concept, Logically and Financially Linked Changes Instead of Partial Changes at the Input and Output of PPIS**

The development and success of the pension reform call for implementation of logically consistent legislative and organizational measures throughout the pension system and in regard of the three pillars and not just an accent on certain aspects, such as insurance contribution rate, years of service and rising pensionable age. The achievement of financial sustainability of the pension system and raising the pension incomes level is possible only provided the outlined measures are targeted both at the input and at the output of the system. A pension reform is not just partial measures in the first pillar; it rather implies a clear vision and concrete measures aimed at the development of all the three pillars of the Bulgarian pension system.

The steps undertaken at this stage cannot be defined either as a continuation of the aims and philosophy of the pension reform dating back to 2000 or as substantial changes in the pension system. Therefore one cannot and should not speak about a pensioner reform rather than partial measures and certain actions aimed at a temporary solution of some problems and putting off the essential changes to some next stages.

The accent of the measures in the sphere of pension insurance is solely and exclusively on the first pillar of the pension system without taking any steps to eliminate the problems and to develop the next two pillars of the pension system. Neglecting the significance of the next two pillars for the sake of a higher replacement rate and a higher level of pension payments respectively will be perceived as a violation of the overall philosophy of the reform.

The serious problems and growing deficit of state pension insurance and the financial instability of the first pillar is directly reflected in the undertaken steps and legislative changes while leaving into the background and eliminating the options offered by the next two pillars in addressing some of the problems of the pension system. Instead of seeking compensatory possibilities in the development of the other two pillars, some partial measures are undertaken to limit the deficit with transient or partial results.

Some more radical changes are needed in pension legislation – both in the part referring to the mandatory public pension system and with regard to the regime regulating the functioning of the system of supplementary pension insurance – both mandatory and voluntary.

At present no steps whatever has been taken for the legislative solution of any identified problems and weaknesses in the functioning of the two capital-funded pillars, although they exist and in time may cause serious difficulties both for the companies and for the insured persons.

### **Clear Priorities, Impact Assessment and Regular Monitoring**

It is necessary to clearly define the priority measures in shorter, medium and longer term and assess the impact on the basis of specific actuarial and financial estimates and regular monitoring.

The need to clearly define the priorities over time and the key measures for their implementation is of substantial importance both for the first pillar of the pension system and for the system of supplementary mandatory and supplementary voluntary pension insurance. That is so both for the legislative in the Social Security Code and for a number of supportive statutes regulating the activities of NSSI, NRA, CFS, the pension insurance companies and the pension funds run by them. In view of the accumulated structural deformities resulting from some political decisions the short-term priority is first and foremost the financial stabilization of the first pillar and the gradual increase of the funds in the second and third pillars. The medium-term priority can be defined as achievement of fuller correspondence between the insurance contribution of the insured persons and the pension payments due to them. The long-term priority of the reform of the pension system is to achieve adequate and sustainable pension incomes.

## **Balance between the Key Principles of Social Security: Solidarity and Correspondence**

The key accent in the steps taken so far towards the implementation of the major objectives of the pension reform is on solidarity in the pension system; they are however not sufficiently targeted on the implementation of the principle of correspondence. Still unresolved are some important issues relating to the equity of the participants in the social security system, the accumulation of non-typical payments not bound up with the insurance contributions, the privileged regimes of early retirement and leveling of the qualifying years of service, accounting for the real insurance contribution in setting the amount of pension benefits, etc.

## **Matching the European Priorities with the National Objectives and Characteristics of PINS**

*Strategy Europe 2000* lays the stress on cohesive growth and calls for reduction of the differences between the individual EU-member countries, including incomes and especially in the level of pension benefits. Bulgaria's serious lagging behind the average level of incomes in EU is even more visible in the light of the average amount of pension benefits in Bulgaria versus the average European level. The logical question in that situation is how to achieve a significant rise of their amount and diminish the difference with the average levels in EU in a situation of huge deficit and funds shortages in the pension system.

## **Measures for Development of the Pension System**

The analysis of the achievements scored so far in the field of the legislative framework, organization and management of the pension system provides grounds for identifying some more important steps to develop the pension system increase its revenues and streamline the expenditures as follows:

- Setting the financial parameters in the operation of the pension system: in respect of the revenue part they refer to the contribution rates, the insurance base and the scope of insured persons;
- Economically justified and financially estimated measures, rather than political decisions, envisaging regular monitoring and updating of the actuarial estimates whenever there are changes in the output parameters of the demographic characteristics and economic indicators, as well as timely alterations in the measures planned by the government;
- Reducing the expenditures in the system not related to any real insurance contributions, i.e. arrangements for early retirement, easier terms of eligibility, awarding invalidity pensions, minimum amount of pension payments;
- Stronger incentives and motivation for more active participation in the social insurance system;

- Tying up insurance payments with insurance contribution: limited administrative setting of contribution rates and insurance payments; eliminating the cap on pensions and maximum insurance income and, in the longer term, minimum insurance thresholds.

Higher degree of correspondence between insurance contributions and insurance payments in the pension formula, not only through the price per year of insurance service but also through a longer qualifying period as a base to calculate the average insurance income in order to eliminate some serious differences in the length of average insurance income for the country;

- Introduction of economic incentives too in addition to the administrative measures for higher insurance contributions: tax concessions rather than changes in the terms of pension eligibility and cash benefits calculation;

- Elimination of enforced administrative constraints related to the financial state of the system through which some key insurance principles are deformed;

- Changes in the organization and stronger control over the collection rate of insurance contributions and payments;

- Better information and staff provision;

- Setting a permanently operating structure with the participation of experts from the relevant institutions, representatives of the social partners, independent experts for ongoing monitoring of policies development, assessment and proposals in the sphere of pension insurance and its administration;

The measures initiated with regard to the employers should stimulate and provide easier conditions for regular payers to fulfill their obligations, as well as sanctions for irregular payers. Some measures that could be implemented at this stage as a step towards developing the supplementary pension insurance system are as follows.

- Smooth increase according to a time schedule of the contribution rate for the UPF - if the current level of the contribution rates to the 2<sup>nd</sup> pillar is maintained it would be difficult to reach the goal set at the outset of the pension reform, i.e. for them to provide 20-25% of the incomes after retirement;

- Higher tax concessions for the persons born before 31.12.1959 in amount not lower than the amount of the contribution to the UPF for the relevant year;

- Options for transfer of funds from an account in SPF to OPF or UPF if there is a shortage of funds for awarding at least the minimum amount;

- Regulated deadline for a possible delay in the NRA transfer of funds for UPF and OPF to PIC;
- Mandatory submission of regular information on the amounts and reasons for delayed transfers;
- Establishing a unit in the NRA with the duty of monitoring the collection rates for the contributions and their transfer to PIC;
- Introduction of an affordable limit between funds remitted and statements submitted as a ground for suspension of the transfers made by NRA to the pension insurance companies;
- Introduction of multitudes - initially for the voluntary pension funds and eventually, for the universal and occupational funds;
- SSC amendments making it possible in certain cases (i.e. financial crisis) to introduce temporary changes in the investment restrictions for some period of time by decision of FSC;
- Complementing the PINS investment regime with a possibility to invest a certain percentage of the assets of the respective pension funds in “other investment instruments”;
- Formation of investment reserves to cover any negative return rate of pension payments in UPF and OPF in the relevant period;
- Introduction of mandatory rules of risk assessment for the pension insurance companies and the pension funds managed by them.

## **7. More Equitable Cost Sharing Needed Between Employers and Employees**

### **Legal Framework and Pension Insurance Characteristics in Bulgaria**

Irrespective of the type of any pension insurance system on a global level, its distinctive characteristics are its conservatism, sustainability, stability over time and, naturally, modernization. If these particular features of the system are not taken into consideration, its key creditor/donor (insured-insurer and government) will lose credibility and it will be doomed to failure.

In turn, the dynamics of the social and economic relationships both imply and demand adequate adaptation and reform of each pension system in keeping with the demographic, economic and social situation in a given territory or community. In fact the problems in the pension systems have always existed since the time their emergence, but they have began to be particularly strongly manifested of the past period of 20- years, on a global level, in the European Union and, specifically, in Bulgaria.

It is to be noted that the Bulgarian approach to minimizing the negative developments in the pension system is demographically targeted on increasing the retirement age and the qualifying labour service period. Less attention has been paid to changes in the criteria for pension calculation and indexing, in contribution rates, sources of financing and control and the prevailing political orientation has been towards minimizing contributions and their centralization.

We do not dispute the fact that the financial difficulties in the pension system are largely a consequence of the exacerbating regressive demographic model in the development of our population and continue to be determined by it; however, there also some other serious causes of these difficulties, dating back both to the period before 1989 and after. Effective in Bulgaria prior to 2000 was the Pensions Act (in force since 01.01.1958) which, though reflecting that period's policy of „universal public ownership”, followed a social contract for a minimum retirement age of 60 for men and 55 for women.

The new Mandatory Social Security Code became effective in 2000, introducing the points scoring system in which the retirement age is raised on an yearly basis by 1 year for men and 6 months for women. That process ended in three years' time for men (2003), for whom the required minimum retirement age was set at 63 years while for women it ended after 9 years (2009), reaching 60 years of age.

Over a period of only 10 years the Mandatory Social Security Code was subjected to 69 amendments (including changing its name to Social Security Code – SSC) and on the eve of 2011 it turned out that

neither the higher age of retirement, nor the introduced so-called points scoring system as criteria had achieved even the least possible effect of ensuring dignified old age for the Bulgarian pensioners. In other words, after the reform of the year 2000 and even after its multiple changes, the Bulgarian pension system is still at the point of departure, expecting the next reform.

From the aforementioned it is to be seen that the legal framework which is essentially a social contract, has been altered many times over. That is not in the interest of the citizens since they plan for the year of their retirement and for the amount of their pension benefit under certain regulations, which are then unilaterally and repeatedly altered to their detriment.

By the end of 2010, after a debate that was relatively non-transparent to the public, the pension system was once again made subject to reform, with a maximum probationary period of at least 10 years according to our estimates.

The instability of the legal framework governing the pension system leads to conditions in which the belief in its viability is lost, especially in the younger age groups and most of all, in the generation of active and beyond active age which shouldered the burdens of the 20-year period of transition at the cost of having minimal and, in some cases, no incomes whatever and no chances of finding employment on the labour market. The same generation that experienced, just in the past 10 years, a retirement age increase of 3 years for men and 5 years for women and an increase of the qualifying period of service actually reaching 12 years for men and 14 years for women. That generation also experienced the collapse of the bank and pension systems in 1996-1998 with monthly pension benefits equivalent to 3 USD.

There is no dispute that the objective demographic processes pre-determine the rise of the pensionable age in the country; however, its setting should not be carried out as an experiment or under pressure by any of the parties to the tripartite dialogue, but as a result of scientifically grounded analyses and prognoses.

### **Actual Cost Sharing Between Employers and Employees**

In our opinion when a system such as the pension system experiences financial difficulties and problems in its functioning, its reform and upgrading should have a priority orientation to a choice of scientifically justified, optimal adequate levers in accordance with the social, economic and demographic situation at any given moment of its existence.

In this paper we shall confine ourselves to only one of these levers, namely, the demand for more equitable cost sharing between employers and workers/employees.

First of all, it should be made clear that the pension insurance system in Bulgaria should be referred, at

present and in perspective and in terms of the political and economic social security models, to the so-called system of mixed type, which definitely is not the most optimal choice in the pension philosophy, theory and practice. There are two motives for it to be referred to this classification:

On the one hand, in its present form of functioning it is both liberal and state-run as a sum of the elements of the two models, including the involvement of third pension insurance entities too, namely, a great variety of pension funds and other subjects, different from the insured physical or legal person. In other words, our pension insurance system is a modification of the liberal and state model with a pronounced stronger influence of the second one.

On the other hand our system is both pay-as-you-go and capital-funded, and in its dominant part it is also solidarity-based and social, and that again could be reported as a bad practice in the pension insurance theory.

Since 2000 our pension system has been based on three major pillars. The first one covers state social security. The second one encompasses the supplementary mandatory pension insurance in UPF and OPF and the third one, supplementary voluntary pension insurance and voluntary insurance against unemployment and/or for vocational training.

The financing of both the pay-as-you-go and the capital-funded components (1<sup>st</sup> and 2<sup>nd</sup> pillars) of the system is carried out through contributions from the employers and from the employed persons, the current proportion being 60:40 per cent. The contributions ratio was scheduled to level out till 2010, reaching 50:50%, but by the end of 2010 that was not done and in our view will not be done before 2014.

A typical feature of the occupational pension funds based on the capital-funded component is that they are financed by supplementary contributions solely at the expense of the employers.

For workers and employees in the first labour category (pilots, miners and many others) the employer's contribution is set at 12.0 per cent and in the second labour category (machine operators, drivers, glass makers etc.) – at 7.0 per cent, both being intended for an occupational pension fund. The contribution rate for the first and second labour category workers to the SSS Pension Fund is equivalent to the total contribution rate for the third labour category increased by 3.0 per cent, again fully on the employer's account. We have to explain here that the occupational pension funds offering early retirement to workers and employees in harmful and specific labour conditions are not only financed from contributions from the employers, but they were also to cover all contributive pensions, such as pensions for old age, occupational disease, employment accident, invalidity as well as survivor pensions ever since 2009 in accordance with the SSC. However that has not happened yet, even up to this day. Moreover, with the most recent amendments in the SSC, starting from 2011 cash amounts



will be transferred from these funds (i.e. from the individual accounts of the insured persons) to the budget of the National Social Security Institute (NSSI) in the amount of 100-150 million BGN. That approach will definitely reduce the financial capacities of the NSSI Pension Fund since in the 2011-2014 period (it is not even guaranteed that the duration of this period will be observed) the pensions of the workers and employees in the 1<sup>st</sup> and 2<sup>nd</sup> labour category will be paid out from the state social security system instead of from the occupational funds.

In 2011 the total contribution rate for persons in the third labour category is equal to 22.3%, including for the Pension Fund - 17,8ct, for general illness and maternity - 3,5 per cent, for unemployment - 1.0 per cent and for the Employment Accidents and Occupational Disease Fund - 0,4-1,1 per cent. For that labour category too the insurance contribution is split in a proportion of 60.0 per cent for the employer and 40.0 per cent for the insured person.

For the purpose of deeper analysis of the actual cost sharing between the employers and the workers we shall examine these proportions (structures) in terms of their type of payment in case of illness, disability, old age, unemployment and employment accident.

The insurance contribution for general illness and maternity amounting to 3.5% is shared as follows: 2,1% by the employer and 1.4 % by the insured person.

For persons in the third labour category born before 01.01.1960 the total contribution to the Pension Fund is 17.8%, of which 9.9% by the employer and 7.9% by the insured person.

For persons born after 31.12.1959 5% of the total contribution are paid to the UPF, of which 3% on the account of the employer and 2% by the insured person.

If the insured persons work in the 1<sup>st</sup> and 2<sup>nd</sup> labour category, the employer's contribution is raised by 3%.

The insurance contribution differentiation depends on the insurance pillar, the labour category and the type of pension fund.

If the contribution refers to an Occupational Pension Fund (currently 10 in number in the country) the first labour category workers are fully insured by the employer through a 12.0 per cent contribution and a 7.0 per cent contribution for the second labour category. The total contribution to the Universal Funds amounts to 5.0 per cent – 3.0 per cent on the account of the employer and the remaining 2.0 per cent – on the account of the insured person.

The contribution rate for employment accidents and occupational disease varies between 0.4 and 1.1 per cent and is fully paid by the employer.

The contribution rate for unemployment is 0.0 per cent of which 0.6 at the expense of the employer and 0.4 per cent – by the insured person.

Unfortunately, due to the limited nature of this study, we are not able to make a comparative analysis of the structural employer-employee insurance contribution ratios, at least within the frames of the European Union, which would have significantly enhanced the level of our analysis.

### **Necessary Changes in the Field of Pension Insurance in Bulgaria**

On the basis of the problems presented above as typical of PINS, we take the liberty of drawing the following more general conclusions, with some reservations that the study of this issue is not exhaustive:

- We do not think that the proposed PINS reform, which is to become effective starting from 2011, fully reflects the actual realities/needs and that it is based on scientifically proved, optimal criteria, parameters and implementation periods;
- The financial difficulties in this system presuppose an all-round change in the philosophy of its reform with a priority attached to its financial, rather than its demographic coverage. Our strongest argument in favour of that is that the demographic processes are relatively stable and their time lag is at least 30-50 years;
- The role and share of the capital-funded schemes should be reinforced with options to provide life-long payments in accordance with the indications of the EC/ILO actuarial methods;
- Some relative reduction of the employers' contributions is also necessary to stimulate business and improve the competitiveness of the Bulgarian economy;
- Mandatory equitable sharing (50:50 per cent) of the insurance burden between workers and employers in order to strengthen the capital-funded characteristics of the system;
- The most important objective of our pension insurance system should be to encourage own account insurance. Its inevitable effect will be to reduce the level of the informal economy to socially-affordable dimensions and, consequently, to prevent concealment of insurance contributions;
- PINS should be developed first and foremost along the lines of ensuring stability of its legal framework and, following that principle, of its adequate modernization.

## 8. Link Between What is Paid in Contributions and What is Received in Pension Benefits

*“Myths are public dreams,  
dreams are private myths”  
Joseph Campbell*

Any pension system, regardless of whether it is financed on the basis of a pay-as-you-go or a capital-funded principle, may essentially be reduced to a single question: what am I to receive in exchange of what I have paid. The arguments concerning the solidarity of the pay-as-you-go financing and, respectively, the individual independence of the capital-funded one, are aimed at providing the required justification of the respective approach. Things seem right as long as each financing mechanism uses its own rules in justifying the link between what is paid and what is received. The myths begin when the fundamental principles of the two financial mechanisms are exchanged.

Are there any myths concerning the link between what is paid in contributions and what is received in pension benefits in the Bulgarian pension system?

As it is, that happens to be a vast subject, but for the purposes of this study it is reduced to the analysis of the specific features of the link itself under the different forms of financing in providing for old age, as well as – of the way it is perceived by the public, the separate individual and the businesses. The mythologization of this link in the pay-as-you-go segment of the pension system creates public dreams the hostages of which turn out to be the separate individuals, while its idealization in the capital-funded segment creates personal myths which may turn the public interest into a hostage.

### **The Contribution-Benefit Link in the Pay-As-You-Go Segment of the Bulgarian Pension System**

The review of the Bulgarian social security legislation and established practice shows that there is a link between what is paid in contributions and what is received in pension benefits for a qualifying insurance period and old age and it is legally regulated through the formula used to calculate the pension amount. The pension amount is determined on the basis of:

- The income used as a base to calculate the pension benefit and,
- The qualifying insurance period.

As with any pay-as-you-go form of financing, solidarity and social justice are central in the Bulgarian first pillar of pension insurance. The degree of public consensus achieved in Bulgaria concerning the link between contribution and benefit may be perceived as a product of two values, which, clothed in

legislative norms, looks as follows: “The amount of pension benefits for a complete qualifying insurance period and old age is determined by multiplying the income used as a base to calculate the pension benefit by the sum obtained as: 1.1 per cent, and, as from 1 January 2017 – 1,2 per cent for each year of qualifying length of service and the relevant proportional part of that percentage for the number of months of insurance service.”

Although the length of the qualifying period represents a strictly individual element, it influences on the link between contribution and benefit in the pay-as-you-go segment as much as the income used as a base to calculate the pension benefit. In turn that income depends on the drive to guarantee the public interest. That is not the individual income at the time of retirement, but income determined by multiplying **the average monthly insurance income in the country for 12 calendar months prior to the month of awarding the pension benefit** by the individual coefficient of the person concerned. This coefficient represents the individual adjustment of the public solidarity. It is calculated on the basis of the person’s income for which insurance contributions have been made for a period of three consecutive years as chosen by the person within the past fifteen-year length of service prior to 1 January 1997 and the income for the period after that date and up to the date of retirement. Naturally, in calculating the individual coefficient, the individual interest is correlated to the public interest for the purpose of achieving social justice. Two correlations are taken into account in calculating the individual coefficient:

- The correlation between the person’s average monthly insurance income for the period up to 31 December 1996 and the average monthly salary for the country in the same period as announced by the National Statistical Institute (NSI);
- The correlation between the average monthly insurance income of the person for the period after 31 December 1996 and the average monthly insurance income for the country over the same period.

The individual coefficient is determined by multiplying each of the above correlations by the number of months for which it is established and the sum of the products thus obtained is divided by the total number of months included in the two periods.

The idea in these mathematical calculations is to establish a link between the contribution to the pay-as-you-go segment of the Bulgarian pension system and the benefits received from it in as just as fair way as possible. In view of the method of financing in that segment, the pension benefit may not be calculated on the basis of the individual sum of the insurance contributions actually made. Therefore the justice is sought in the comparison of the individual average monthly insurance income (taken as a base for the person’s individual contribution input) and the average monthly insurance income for the country (taken as a base for the total insurance contribution input by all insured persons). As average values are used, the relativity of the justice being sought is inevitable. That relativity can also

be attested from the fact that, for objective reasons, the average monthly wage before 31.12.1996 reported by NSI is taken in the formula as a base for the total insurance contribution input. The presumption is that if the average weighted correlation underlying the individual coefficient takes part in the determination of the income used for pension benefit calculation, then the contribution-benefit link should be just and fair. Regardless of its financial grounds, the justice sought through that formula in the link within the pay-as-you-go segment possesses a clearly visible political dependence – the key values participating in the formula, as well as the formula itself, may be changed at any time, provided there is a political will to bear the respective financial consequences for the system. The mythologization of the individual coefficient as an absolute guarantee for the individual interest and as unconditional justice creates a beautiful public dream: “By that formula everyone receives an adequate pension benefit”. Adequate to one’s insurance contribution input under certain condition – yes. Adequate to one’s need to keep up one’s living standard after retirement – definitely no. Unfortunately, such is the mass public perception.

Statistics point to something different. According to NSSI data published in “Social Security in Bulgaria in 2009” the replacement rate of the net income for length-of-service and old-age pension benefits in 2009 was 60.65 per cent (calculated as a ratio of the average monthly amount of the pension benefit per pensioner and the average net insurance income). Perhaps the dictum saying that when numbers speak even pensioners keep silent will prove to be true for Bulgaria. With the exception of several demonstrations against the most recent amendments in the Social Security Code concerning the early retirement of the category workers, Bulgaria was relatively peaceful against the background of the formidable stormy protests against the measures taken in the pension systems of some other EU-member states. It would be too beautiful a public dream to believe that the relative silence is due to the all-round satisfaction of the Bulgarian citizens with the Bulgarian pension system and results from the welfare of the pensioners in the country. There is a well-grounded doubt that the lack of such drastic public response should rather be sought in the growing public apathy in regard to the pension system: fewer and fewer people hope and believe that mandatory pension insurance would guarantee a decent standard of living, so “*what does it matter how much the retirement age or length of service will be raised*”. Such public attitude should not come as a surprise. Thanks to the option of finding work in other member states of the *European Union (EU)*, some Bulgarian citizens are already wondering how for just three years of work, for example in Spain, they could receive supplements to their pension, equivalent to the pension benefit received in Bulgaria, for which they have worked thirty years. In the modern information society that individual response rapidly becomes news and reaches every household via the electronic media. That in turn deepens the common distrust towards the mandatory pension insurance in Bulgaria. There are many different well-known objective reasons and factors for the insurance disproportions in the different national systems, related to the demographic situation,

employment, income level, inflation, labour productivity etc. The problem is in the fact that the proudly flaunted replacement rate in the first pillar of the Bulgarian pension system may not be considered only under “other things held equal”, simply because the conditions in Bulgaria are not that equal to those in the other EU-member states. The accession to the European Community deepened the public sensitivity on that issue. Thus the net income replacement of 61% has different dimensions under a different living standard. Furthermore, according to the total income structure of the households in Bulgaria by sources of income announced by the NSI, it is obvious that pension incomes are the second item of significance in the family budget, after wages. In the third quarter of 2010 pension incomes accounted for 30.5 per cent of the total household income, whereas in the third quarter of 2009 that share was 28.4 per cent.

Though relatively silent, the Bulgarian pensioners have repeatedly raised questions that strongly politicize the contribution-benefit link, in particular:

- Why is the weight of the length of service just 1.1 in determining the pension amount?
- Why does the average monthly insurance income taken as part of the formula amount to exactly 12 calendar months prior to the month of awarding the pension benefit?

According to the most recent amendments in the SSC effective as from 2011, starting from 1 January 2017 the weight of the qualifying period will be 1.2 (*it used to be 1 before 31.03.2009*). So far there have been no changes in the 12-month period (*up to 31.12.2003 the previous year was used instead of the 12 calendar months prior to the month of awarding the pension benefit*).

The link between contribution and benefit in the pay-as-you-go segment is also influenced by the legally regulated **minimum and maximum pension amount** as well as the **method of pension updating**. In 2011 **the minimum monthly amount of the pension** for old age and complete years of service is 70 euro (set as an absolute amount in the SSSBA) while the **maximum monthly amount** of one or more pension benefits received is set at 358 euro (set in SSC as 35 per cent of the maximum insurance income for the corresponding calendar year, as defined in SSSBA). Pensions awarded before the 31<sup>st</sup> of December of the preceding year **are updated** every year on the 1<sup>st</sup> July by resolution of the Supervisory Board of the National Social Security Institute by a percentage equivalent to 50 per cent of the growth of the insurance income and 50 per cent of the consumer price index in the preceding calendar year.

Although the legally established parameters and their specific values reviewed so far are naturally dictated by the financial estimates of the SSS Pension Fund, the political element is no doubt decisive in determining the extent and time of manipulation of the contribution-benefit link in the pay-as-you-go segment.

## **The Contribution-Benefit Link in the Capital-Funded Segment of the Bulgarian Pension System**

The review of the Bulgarian social security legislation and established practice shows that the link between what is paid in insurance contributions and what is received in pension benefits in the capital-funded segment of the Bulgarian pension system exists and it is legally regulated through the rules of pension amount calculation. The pension amount is determined on the basis of:

- The accrued funds in the individual account;
- The biometric tables approved by the FSC Deputy Chair, respectively – the period of fixed-term pension payment;
- The technical interest rate of the pension insurance company approved by the FSC Deputy Chair.

Naturally, the amount of the technical interest rate is derived from the financial estimates in the capital funds, but in contrast to the pay-as-you-go segment, with the capital-funded one the market is decisive in setting the degree and time of manipulating the contribution-benefit link. Although that link in the capital-funded segment was put to a serious test by the world financial crisis, the capital pension funds already accrue positive yield and are gradually returning to the levels which the public was used to seeing as natural and inherent to them. However, the crisis-inspired heated pension debates in the public were the reason for Bulgaria to experience the first mythologization in its pension system after the year 2000.

### **Mythologization in the Bulgarian Pension System**

The mythologization of the contribution-benefit link in the pay-as-you-go segment of the pension system generated the public dream of how the same assets, if transferred from the capital-funded to the pay-as-you-go segment, may secure pensions of several times higher amount. Although the social partners, the government and the legislative authorities managed in the end to declare consensus on the issue of early retirement for the category 1 and 2 workers and on the meaning of transferring funds from the mandatory occupational pension funds to the SSS Pension Fund, the hostages of that myth proved to be the separate individuals who, during the last days of 2010, besieged in long lines the Regional Social Security Offices in order to submit their documents for retirement under the *mythically* good old conditions. On the other hand, the idealized long-term funds accrual inherent to the capital-funded segment created personal myths for those who perceived it erroneously as a constant and an unconditional short-term process and who, due to ill-advised conduct or indisputable need, withdrew their funds in a situation of a universal decline of the financial markets and thus encased individual downturns. That shed public doubt on capital-funded insurance at large. After the stormy public debate concerning the mandatory occupational pension funds at the end of 2010, the eventual political influence over the contribution-benefit link in the capital-funded segment is no longer just a theoretical postulate. Such non-market intervention seeks motivation in a kind of solidarity not typical for the capital-funded segment. Besides, some displacement of principles also

appeared in the pay-as-you-go segment. The transfer of assets from the mandatory occupational pension funds to the SSS Pension Fund caused the pay-as-you-go segment to become engaged (regardless of its inherent solidarity) in a function typical for the individual independence of the capital-funded segment: reimbursement of money transferred from these funds and of insurance contributions received after 31.12.2010 to pensioners and heirs (paragraph 6 and 7 of §4a of the Transitional and Conclusive Provisions of SSC). In other words, the usual political mechanisms of exerting influence on the contribution-benefit link in the pay-as-you-go segment are already complemented with a certain market twang, and the inherent market nature of that link in the capital-funded segment has a political nuance too.

### **From Myths to Partnership**

The present analysis leads to the question: what can be done to prevent the individuals from becoming hostages to public dreams created by the mythologization of the contribution-benefit link in the pay-as-you-go segment, and to prevent the establishment of a multi-pillar model as a guarantor of social security (indisputable public interest) from becoming a hostage to the idealization of that link in the capital-funded segment.

The answer lies in the partnership between the pay-as-you-go and the capital-funded segments. It is inevitable before the systematic balancing of their specific hazards, but in order to avoid any future manifestations of jealousy between the two segments, each one of them should apply its own rules in justifying the link between what *is paid* and what *is received*. To come up with a concrete proposition in response to the question raised, it is necessary to consider the problem not only through the “individual-society” prism. The meaning of the pension system cannot be reduced only to what the individual gives to the society and what one receives from it. The same is also valid for the business. The payment of mandatory social insurance contributions should not be examined only as a legal duty of the employer. It should become an economic development incentive, but not necessarily along the line of mechanically reducing the contribution rate. On the basis of the legal framework for the occupational pension schemes built up in Bulgaria in 2007 (transposed Directive 2003/41/EC), while applying the established European practice, the Bulgarian legislator could provide an additional legal option to sponsoring undertakings – use of insurance concessions from the pay-as-you-go segment of the pension system, provided an occupational capital-funded scheme financed by the employer provides a supplementary pension benefit of a minimum amount not lower than a legally set minimum level for that purpose. Thus the contribution-benefit link would be tangible both for the individual and the business. The employer will be able to enjoy the loyalty of his employees while pursuing its personnel and qualification policies and will, jointly with the pension insurance company managing the occupational scheme, be also committed to providing adequate sustainable and safe pensions.



## **9. Early Retirement In Case of Hazardous Conditions of Work: Need for Better Definitions and Application of the Labour Categorization Criteria**

### **Historical Aspects of Labour Categorization in Bulgaria**

The first law laying the foundations of pension insurance in Bulgaria dates far back to 11.11.1886 and was specifically designed for the war invalidity pensions of injured Bulgarian citizens just 8 years after the country's liberation 1878.

Two years later (15.12.1888) the next Teacher Pensions Law was passed, which entered into force on 12.01.1889 after its promulgation in the State Gazette. One would be justified in assuming that these two laws, though fully intended for specific groups (categories) of the population, laid the foundation for the future development of the Bulgarian pension insurance system.

The formation of the funded system of social and pension security is believed to have been completed with the adoption of the Social Security Law in 1925 and the Law on Pensions for Length of Service in 1932.

The first beginnings of state social security appeared with the foundation of the Social Security Institute in 1941 with the key task of ensuring the effective functioning of the social security system. Unfortunately only nine years later (1951) capital-funded social security was liquidated and replaced with the budget.

The Law on Social Security adopted in 1948 not only replaced the one in force since 1924 but also completely changed the philosophy of our pension insurance system by replacing the fundamental principle on which it had been based until then, i.e. that pension entitlements should be based on individual contributions to a specific fund. After 1948 the insurance contributions of the workers and employees were fully at the expense of the state institutions and enterprises.

With the so-called Regulation on People's Pensions with the force of a law a new category of rightful claimants appeared, including persons who have suffered in the fight against fascism in the period between 09.06.1923 and 09.09.1944. The differentiation in the category of the so-called "active fighters" covered 4 groups:

- Active fighters against fascism and capitalism (AFAFC);
- Those who have suffered in the fight against fascism and capitalism, with over 30% loss of working

capacity;

- People active in the field of science and the arts and public figures who have contributed to that fight;
- awarded survivor pensions to the parents of deceased anti-fascists, their underage children and spouses.

Furthermore, the Law on Depriving Persons Involved in Fascist Activities of Pension Entitlements was promulgated on 14.02.1948. What was typical of that lustration and discriminatory law was the fact that as a result even survivor pensions were taken away and no length of service was recognized for state employees and for a number of officials such as police officers, mayors, deputy mayors and others.

The philosophy of the Law on Pensions implemented in Bulgaria since 01.01.1958 was the assumption that the pension is a form of recompense and not a consequence of real insurance of the persons concerned. That law was in force till the adoption of the Social Security Code (SSC) in 2000.

### **Status and Dynamics of the Early Retirement Criteria in Bulgaria in the Period from 1999 to 2011r.**

Before dwelling on the analysis of the indicators characterizing the criteria of labour categorization of employed persons in terms of their early retirement prospects, let us explain some basic concepts of our pension insurance system.

Thus, for instance, by pension **insurance system** we mean the type and method of organizing in the system of pension insurance with the social, demographic, social and economic relations mutually dependent and dependent on it.

The **pension** itself represents a dynamic monthly cash remuneration to which a concrete pension-eligible person is entitled under certain satisfied criteria for years of service and old age, differentiated in accordance with the specific conditions of work.

Under the pension system applied till the end of 2010 pension entitlement was acquired as a result of the cumulative satisfaction of two indicators: completed old age and length of service brought together in a point scoring system of at least 100 points for men and 94 points for women.

Three major labour categories are differentiated in our pension insurance system, which should be referred to the so-called mixed systems (resting on the pay-as-you-go and the capital-funded principles) characterized by lower requirements with regard to certain differentiated groups of workers. It is to be noted that the category type constitutes an important inseparable part of the employment contract and is included in the job characteristics of the worker or employee. The labour

categories are duly described in the Regulation on Labour Categorization upon Retirement (RLCR) adopted with Decree No. 235 of the Council of Ministers (CM) dated 20.10.1998r. (3, 6, 7), where:

- The **Ist category** refers to **workers underground** (for instance, miners), **under water** (diverse) **and in the air** (for instance, pilots), e.g. **the criterion of working conditions is adopted**. In total 9 groups of workers in these occupations and those derived from them are differentiated in the Regulation;
- Differentiated in the **IInd category** are 44 groups of workers and as many sub-groups in the assumption that the one cannot work in the relevant occupation after completing a certain age, which is necessarily lower than the one generally valid for retirement. What is typical of that category is that its criterion is **based on the occupational orientation and foundation**;
- The **IIIrd category** covers all the rest – those who are not covered in the Ist and IInd labour category (3, 4).

We would venture here that there is another, “hidden” category as we call it, namely, that of state employees, military, employees of the Ministry of the Interior and the special services whose insurance contributions are fully at the expense of the state budget. Moreover, with its factual existence that fourth category has an extremely negative effect on the budget of the National Social Security Institute (NSSI) and that of the National Health Insurance Fund (NHIF) since, on the one hand, the government does not always regularly remit the contributions due to NSSI and, on the other, when it does, the amounts happen to be lower or not complete.

The employers and the trade unions in Bulgaria are united around the proposition that the state employees should be as equally obliged to pay their insurance contribution as the other workers and employees and therefore, since they are relieved of the obligation to pay personal insurance contributions, they have become a privileged stratus (in the absence of any constitutional grounds for that).

**The objective of our study** is to confine ourselves to the positive aspects, omissions and shortcomings in the definitions and qualification criteria, referring only to the first and second labour category.

On the basis of the analysis thus performed, we set ourselves the task, **as a sub-objective**, of suggesting optimal options for the prospective improvement of these criteria since our newly-reformed pension insurance system will be inevitably faced with that necessity at the very outset of its functioning (from 01.01.2011).

That incompatibility of the applied criteria is observed even in regard of the differentiated two types of categories (I<sup>st</sup> and II<sup>nd</sup>), distinguished by the provided early retirement options to the workers and

employees referred to them, in contrast to all other employed persons in the third labour category. Thus while a clear criterion is adopted for the 1<sup>st</sup> labour category (persons working underground, under water and in the air) – the conditions of work, for the workers and employees in the II<sup>nd</sup> category it is definitely extendable, vague and diluted since it is mainly based on the type of occupation.

In other words, the criteria applied in differentiating the two categories are not only incompatible, but also unacceptable in principle. When any parameter or indicator is grouped (differentiated), the basic rule in the science of statistics is that the group should be homogeneous (workers/employees/employed persons) and one can then differentiate different sub-groups on that basis, but it is mandatory to do so by one or several comparable indications (i.e. conditions of work or type of occupation, branch, sector etc.). That rule is definitely not observed in the Regulation on Labour Categorization upon Retirement and thus possibilities are provided for pressure against the employers. (3, 8).

What follows from the above is the logical conclusion that the Regulation should be updated as soon as possible, choosing a unified, comparable, or at least harmonized criterion for the two labour categories. We have to explain that there is nothing new in this idea if we keep in mind that that in the old Regulation on Labour Categorization, Instruction № 13/2000 and Letter № 91-01-82/2001г. (3, 4, 7), the enterprises and the corresponding jobs were specifically named in the relevant categories, i.e. one and the same criterion was applied in both categories - the conditions of work.

While we are far from the idea of bringing back the old system of categorization, we definitely cannot accept the currently effective Regulation as objective and optimal one. The choice of an adequate criterion for the pension system is subject to in-depth scientifically grounded research, carried out on the basis of multi-functional teams and multi-optional models which are not subject of this paper.

On the other hand, our motive for updating the categorization criteria proceeds from the dynamic social and economic processes in the country, particularly after our accession as a full-fledged member of the European Union (EU). The implementation of the European social model in Bulgaria is determined by the harmonization of our legislation with that of EU. It is to be noted that as of today our country has meet the harmonization requirement in the field of health and safety at work (HSW). Besides the legal framework regulating HSW is extremely voluminous, inherently contradictory, non-systematic and beset by numerous legal and technical defects. Just the laws regulating health and safety at work in Bulgaria are more than 31 there are more than 22 regulations, more that 181 ordinances and other 108 rules/instructions/guidelines, with the number of normative acts exceeding 300, and a total number of more than 5000 pages. A large part of these statutes need legal and technical upgrading, systematization and codification to eliminate any internal contradictions, clarify the legal text and ultimately achieve their unambiguous interpretation and application.

The harmonization of these exceptionally difficult and sensitive issues seeking primarily the

improvement of the conditions of work will inevitably and very shortly lead to harmonization of the criteria and even of the systems of pension insurance within the frames of the European Community.

Under the currently applied (till the end of 2010r.) and even in the newly-reformed pension insurance system (in force since 01.01.2011) the employers invest and will be obliged to invest more and more funds for preserving the workers' health and provide comfortable conditions of work. Under the Regulation currently effective and in the near future the employer is obliged to continue to pay the contributions of the first and second category workers. Hence the question arises what interest does the employer have to invest in improving the conditions of health and safety at work? The answer to this questions is to be found in the fact that it is definitely not the differentiated contribution against employment accident and occupational disease so much as the possibility for a review of the social security contributions concerning the heavier occupations that will be in the business field of vision and interest to invest more money in work environment. In other words, if the employer is stimulated by having to pay lower insurance contributions for his workers, even as low as 10 per cent, in exchange of improving their working conditions, he will be motivated by the knowledge that his investment will yield some return. With the above considerations concerning the harmonization of our legal framework with the EU legislation in that area on the one hand and, on the other, with the provision of some concessions to business in return for its investments, the inevitable result will be better conditions of work for the workers and employees. The logical effect of that will be the dropping of some existing occupations and the rise of new ones, with definitely improved conditions of work, increasingly meeting the modern requirements. The employers see an alleviated pension system in respect of labour categorization in the formation of a system of social audit whose scope extends to the level of insurance contributions for employment accidents and occupational disease, depending on the occupational hazard in the respective economic area, sector, branch and even enterprise. The social audit should rest on the principle of social partnership (an equal number of worker and employer representatives) with the key objective of assessment of the working environment, including assessment of a specific company for a possible change of its insurance status and re-categorization of its workers. Of no less importance to business is the problem of hazardous work allowances. One should definitely accept as constructive the Bulgarian employers' view on adding that type of allowance to the core labour pay (wages).

### **The Newly-Reformed Pension System in the Aspect of Early Retirement: Prospects, Problems and Decisions**

The defects of the pension insurance system in Bulgaria (in force till 2011) are manifested primarily in low incomes of the pensioners, financial problems of the system and social insurance contribution levels that are both unaffordable for the workers and employees and inadequate for its normal

functioning.

Are there any chances for the newly-reformed system to eliminate or, at best, to minimize the defects of the previous one? The positive answer to that question depends on the solution of the following issues:

- The new pension system should follow the changes as planned in it and not delay again the prospective solution of the problems;
- the reforms in the pension system should include continued closing of the pension age gap between the 1<sup>st</sup> and 2<sup>nd</sup> category workers and the other workers and employees (up to 31.12.2014 the 1<sup>st</sup> and 2<sup>nd</sup> category workers will begin to receive pension benefits earlier than those in the 3<sup>rd</sup> category by 13 years for women and 11 years for men; from 01.01.2015 the early retirees' age will be reduced by 6 months for each calendar year until an 8 years lower age level is reached for the 1<sup>st</sup> category and 3 years lower age for the 2<sup>nd</sup> category as compared to the age level required for the 3<sup>rd</sup> category );
- The pension system should abandon the occupational orientation criterion and introduce that of working conditions which is preferred by the employer representatives. For example, according to the criteria already adopted divers (1<sup>st</sup> category) will be eligible for a pension if they have served 15 years on that job regardless of their age;
- Ballet dancers and dancers (2<sup>nd</sup> category) will have the same right irrespective of their age if they have 25 years of service on that job in cultural institutions;
- In calculating the pension amount one year of service of workers under the conditions of the 1<sup>st</sup> category (for example, miners underground) will still be counted as three equivalent years of service in the 3<sup>rd</sup> category. The status quo of the old system is also kept for workers, engineering and technical specialists, including section heads, working underground in mines etc. as defined in the Regulation;
- The pension regulations should alter the contribution rate paid by insurer and insured in the proportion of 60,0 – 40,0 per cent.

In conclusion, even though this is not an all-embracing, comprehensive and exhaustive analysis of the issue under consideration, we take the liberty of summarizing it with the following conclusions:

There is a risk for the newly-reformed pension insurance system effective since 01.01.2011 to largely repeat the mistakes and defects of the old one; that is equally applicable to both categories of workers benefiting from their entitlement to early retirement.

Secondly, the new system is also predominantly oriented to the pay-as-you-go rather than to the capital-funded principle, which in our view is definitely an inadequate, or at least, not an optimal

approach to minimizing the weaknesses of the old system. The first (state pension) system was characterized by the fact that the funds for pensions are taken from the earnings of the people of active age under the form of pension insurance contributions, against which they receive the promise that they will receive state pensions when they fulfill the relevant criteria. The latter, as we have seen in Bulgaria over a period of slightly more than 20 years, are unilaterally changed by the government to the detriment of the conscientious tax-payer and to the benefit of the irregular. Moreover, there are no guarantees whatever that the most recent changes will be kept in their initial form even in the nearest future.

Thirdly, employers are in favour of the capital-funded system being a priority in the philosophy of pension insurance that would lead to absence of any differentiation by categories, age, employer-worker costs, class of economic activities etc. as the individual (worker) would be personally interested in accruing capital in the form of individual savings - social insurance contributions in an individual account upon reaching optimal age. One will receive such a pension as annuity for life while one's accounts will be managed by private pension funds (companies) freely competing among themselves. The government role is then only reduced to control and guarantee functions in investing the capital accrued in bonds and infrastructure projects. The state should not appropriate people's right to choose and tackle aspects of their personal life, no should it favour incorrect payers of social insurance contributions at the expense of correct ones. To continue such practices would only have the effect of discouraging both groups of citizens from paying their social security contributions and of exacerbating the financial problems of NSSI.

### ***References:***

1. Regulation on Labour Categorization for Retirement approved with Decree № 60 of the CC of BCP and the CM on 28.12.1967;
2. CM Decree № 75/31.03.1998, SG 102/1967 abrogating the Regulation on Labour Categorization for Retirement adopted with CM Decree 60/1967;
3. Regulation on Labour Categorization for Retirement, CM Decree № 235/20.10.1998, SG, 123/23.10.1998;
4. Instruction № 13/31.10.2000, prom. SG, issued 94/17.11.2000 on the implementation of the Regulation on Labour Categorization for Retirement;
5. CM Decree № 21/2006 on setting a new social pension for old age;
6. CM Decree № 180/2006 on setting new pension for length of service and old age for a single indexing of labour pensions since 01.07.2006;
7. Letter № 91-01-82/21.03.2001 on complementing the lists under Art.. 2, para .4, item 6, letter „C” and item 10 of OLCR;
8. Pensions and Length of Service Ordinance, SG, issue 1

## **10. The Currency Board and Reforms in the Pension Insurance System**

The introduction of the Currency Board (CB) system in 1997 and the new pension insurance system model (PInS) in 2000 were preceded by a whole range of key decisions on the concept and the subsequent course of the so-called Bulgarian market transition. In summary they included: 1. Foreign Debt Moratorium (1990) and rejection of an alternative agreement with the foreign creditors; 2. Stepping up the market and structural reforms after the liberalization of most prices of staple goods and services, currency and interest (February 1991).<sup>2</sup> 3. Conclusion of an agreement with the foreign private creditors (1994), national debt restructuring and securitization with the issuance of the so-called Brady bonds 4. New debt crisis (1996-1997) provoked escalating hyperinflation and devaluation of the national currency 5. Start of the negotiations and finalization of a credit agreement with IMF on the introduction of CB (1996 - July 1997)<sup>3</sup>. 6. Design and restructuring of the budget mechanisms and the social security model and laws (1997-2001)<sup>4</sup>.

### **Typology and Interaction Mechanisms between CB and PInS**

With the adoption of the Law on the Bulgarian National Bank (BNB), SG, issue 46, 1997 (LBNB), the BNB Emission Department took over the major functions and operations under CB, as reflected in its balance sheet on a weekly basis. The experience of a limited number of countries was used, most of them from the periphery in the world economic relations and exchange, which in the preceding 20-30 years had relinquished the discretionary monetary policies of the central bank. The Bulgarian CB is different from the so called traditional (orthodox) model<sup>5</sup> inasmuch as the liquid currency assets (FX) cover the total liabilities including not only the banknotes and coins in circulation (C) and the minimum mandatory reserves on deposits of CB(R), but also the government fiscal reserve and the deposits of other „quasi-state” institutions (G), with a balancing position of the deposit of the Banking Department in the Issue Department (B). In addition CB is the last resort lender of the commercial banks (ComB) in case of any system risk, under some very stringent restrictions defined in the LBNB,

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<sup>1</sup> It is widely accepted that s.c. “Plan Run - Ate” has dominated the basic concepts of Bulgarian Market Transition . In the framework of this plan for the first time a proposal was given by Steve Hanke for adoption of Currency Board and dolarization of Bulgarian Economy. (Kurt Schuler, CURRENCY BOARDS AND DOLLARIZATION, [www.dollarization.org](http://www.dollarization.org) ) Hanke and Shuler were also the main consultants on CB among responsible experts on behalf of IMF which have elaborated the conditions under loan agreement between 1996 and 1997.

<sup>3</sup> The related impact is a shock restructuring of Bulgarian industry and Banking System which deserves a separate in depth study and impact assessment.

<sup>4</sup> The basic principles for pension system reforming are implemented in some other neighboring countries reflecting the experience and concepts in the framework of technical assistance provided by World Bank.

<sup>5</sup> The Foreign Currency Reserves cover in full often with a surplus of 10% just the money in circulation. Among referred authors are Kurt Schuler and D. Dobrev (Д. Добрев, Паричният съвет в България: устройство, особености и управление на валутния резерв, юни 2000) and others.



and exercises regulating and supervisory functions through the Banking Supervision Department of BNB.

Thus the current status, CB operations, the cash base (C+R) and the total monetary supply (MS) depend directly on:

- Currency asset changes (FX) i.e of the total balance of payments (trade balance, foreign services balance, direct net private investments, transfers and capital operations);
- Investment policy and changes in the market value of the portfolio of the Banking department, including loans extended to Commercial Banks (B);
- Money multiplier (m)<sup>6</sup>;
- Fiscal reserve and deposits of quasi-state institutions (G).

It is assumed that with the Bulgarian CB *the government (the Ministry of Finance has special discretionary functions vis-à-vis the monetary policy*<sup>7</sup>. All key budget operations – tax collection, non-tax revenues, health insurance and social security contributions, government bond transactions, budget expenditures, transfers, subsidies etc, including those for PIS, influence the current fiscal reserve and deposits level (G). Under equal other conditions (not involving foreign assets - FX of CB), the cash base (C+R) and the total money supply related to it via the money multiplier (m) (broad money - M3) are subjected to the reverse proportional influence of the current amount of the fiscal reserve and the deposits of the quasi-governmental (G). In turn the fiscal reserve and the deposits are related to the current and annual execution (realized deficits and surpluses) of the consolidated fiscal program. Of course, that happens within the frames and under the restrictions of the general economic situation, the current fiscal policy and the central budget adopted, the consolidated SSS budget and, in particular, the budget of the Pension Fund and some other funds administrated by National Public Security System the budget of the National Health Care Fund etc

The relationships between the CB operations and the financing of the social assistance and social security systems (health, health insurance, administration of social security risks, entitlements, compensations and pensions) are dependent on the relationship between the fiscal reserve and the "quasi-governmental" deposit on the one hand, and, on the other, on the effect upon them of the government expenditures on transfers for social spending and subsidies covering budgeted and actual deficits in the consolidated budget of NHIF, SSS and, in particular, the budget of the Pension Fund.

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<sup>6</sup>  $m = (1 + c) / (c + r)$ , where  $c$  – money in circulation to overall deposits,  $r$  – reserves of commercial banks to overall deposits (Kurt Schuler and other authors).

<sup>7</sup> D. Dobrev and other authors.

The attached Table reflects the positions of the balance of the Issue Department and the link with the deficit and the fiscal coverage of the total social and insurance costs, including those of the public segment of PInS. (Pension Fund of SSS) during the 1997-2010 period. What makes impression is that throughout the entire period the coverage of banknotes and coins in circulation with foreign assets has remained between 2.4 and 3.1 times higher and that of the cash base – between 1.6 and 2.4 times higher. Most significant are the changes in the relationship between the fiscal reserves and the “quasi-governmental” deposits and the money base from 1:1,1 in 2000 to 1:2,4 in 2010. In our view that conforms with the hypothesis of the *discretionary nature of the fiscal policy being followed with regards to the money supply under the specific conditions of the Bulgarian CB.*

In tracing out the dynamics of the assets and liabilities positions of the CB one can differentiate the following periods and key performance benchmarks associated with them to facilitate the analysis of the links with PIS:

- 1997-2000 – a period of „testing” the initial and maximum levels of coverage of the money in circulation. The absolute peak of the restrictive monetary and fiscal policy dominated by super guarantees of the monetary base with liquid foreign assets coverage (over 2.4 times) was reached in 2000. The fiscal reserve and deposits exceeded the money in circulation by more than 8%, reaching a maximum share in the total currency assets of 45% for the whole period. The share of transfers, subsidies and other financing in the total SSS expenditures increased from 6% to 18% (20,6% in 2001) and to about 2% relative to the GDP;

- 2000-2008 was a period of „expansion” in the money supply dominated by growing DPI, bank loans with foreign financing and transfers. The “bottom” of money base coverage with liquid foreign assets was reached in 2007 (1.64 times). In 2007 the share of the fiscal reserve and deposits versus the money base dropped to 48% and versus foreign assets – to 29%. The share of transfers, subsidies and other financing in the total SSS expenditures grew from 20,6 % in 2001 to about 34 %, reaching 3% of GDP in 2008;

- 2009-2010. The inception of that period was preceded by exacerbation of global economic crisis after 18.09.2008, which had a direct negative shock effect on the total balance of payments. The fiscal, social assistance and social security policies and, consequently, the “discretionary” policies of the governments in that period also changed. The coverage of the money base with foreign assets in 2009 increased up to 1.95 times (1.8 times in 2010). The share of the fiscal reserve and deposits in the money base reached an absolute minimum level for the entire period since the introduction of CB of 42%, and in the currency reserves – of about 23%. In the expected performance for 2010 the share of transfers, subsidies and other financing in the total expenditures of SSS has probably grown from about 51 % to over 60 %.

The share of foreign financing of the Pension Fund (including 12% budget transfers for 2009 to the total insurance income) as against the fiscal reserve and deposits grew from 16% (2000) to about 46% (2009), leaving a provisional declining trend in 2002-2005. Similar dynamics of change can be traced in respect of GDP with an initial level of foreign financing of about 2% (2000) going up to 5,1% (2009.).

Naturally, the links between PIS and CB are not reduced only to the aggregate monetary and financial flows between the consolidated fiscal program and the balance of the BNB Issue Department. There is a *specific macroeconomic framework of current and long-term effects of the CB operation on PInS*. They are basically related to the blocked operation of some key economic instruments, such as setting the basic interest rate and the discretionary monetary policy of the central bank, the limited (restricted) framework of the monetary, fiscal and process policies and the fixed currency rate for the payment transactions on the key foreign markets.

Irrespective of the specific features (small economy, open to external shock, under the Bulgarian CB in force now, the basic influence over the GDP and the general economic, social and demographic development is firmly dependent on the payment balance and the current currency reserves amount. Some key parameters governing the economic dynamics are the direct foreign investments inflows and the net balance of the foreign exchange of goods and services, which influence the money base and the general money supply (with a relatively limited fiscal policy), as well as the options for growth of labour productivity and employment, average wages and consumption.

In turn they influence directly some of the key parameters of the actuarial balance, including the number of insured, the average insurance income, as well as a number of processes and demographic development and migration structure parameters by which they are characterized.

### **Transformation of CB and Reforming PInS**

Bulgaria's accession to EU (2007), the introduction of the key principles of the so-called European social model in respect of PIS and the unleashed global economic crisis (September 2008) necessitated a series of legislative changes in the 2000 model. A multitude of changes were introduced in the Social Security Code, including those at the end of this year, as examined in the preceding parts of this study. Parts of them are radical in nature, i.e. assuming insurance obligations for 1<sup>st</sup> and 2<sup>nd</sup> category workers and transferring part of the necessary financing from their individual accounts in the private occupational pension funds (the so called second pillar) to the first pillar (the SSS Pension Fund); changes in the qualifying length of service and age and abolition of the scoring points system and reducing the insurance contribution rates (increased by the end of 2010 by 1.8%), etc.

The current government has repeatedly stated its firm intention to apply and enter as soon as possible

ERM II, in 2012 and 2014 respectively. It is stressed that apart from the financial security and predictability and limiting the current financial deficits and government debt and financial reserves accrual, Bulgaria has not yet benefited from the substantial advantages of that peculiar type of monetary system. These statements are essentially a request for a controlled way out of CB.<sup>8</sup>

The main objections against the accelerated course to the Euro zone refer mainly to low competitiveness, the possibility to maintain the five Maastricht criteria (basically rising inflation as necessary to reach the average European price level) and the need to maintain an even more restrictive monetary and fiscal policy. Doubts are ever more clearly expressed in connection with the continued global economic crisis, “Hellenization” of the problems-ridden countries from the Eurozone, the pressure upon the euro and its future as one of the leading world currencies. Much more limited is the debate on the necessary preparatory and successive legal and institutional reforms in the monetary, fiscal and social insurance policy.

The future changes in PIS in terms of the synchronization of the changes in the monetary and fiscal policy related to the eventual accession to ERM II и the Eurozone should tackle a major issue. It is necessary to significantly reduce and, if possible, eliminate the financial pressure of a number of unreformed systems on the fiscal reserve, including spending on transfers and subsidies to cover the deficits in the Pension Fund and the SSS. Furthermore one should also consider the need of keeping on the caps on the current budget deficit and the total national debt in GDP. The significant insurance contribution rate increases phased over time as proposed during the bipartite and tripartite consultations between the social partners in 2010 are both the easiest and the most erroneous solution. Clearly under the terms of the CB each net increase in tax and insurance contributions and liabilities has a direct adverse effect on the money supply and hence – on economic growth, employment and consumption. A similar negative de-motivating effect is observed not only on a macro level, but on a micro level too, insured and insurers included. That impact is even more significant in the conditions of continued recession, pressure on the balance of payments and limited possibilities for currency assets growth<sup>9</sup>

The policy of escalating contribution rates, alienation of targeted funds (NHIF reserve, individual accounts in POF), funds treatment etc. should be reconsidered. The silver fund and other funds and off-budget accounts should be considered as part of the fiscal reserve, with restrictions encouraging more effective, risk-balanced investment. The PInS reforms should not be suspended, delayed or reduced to palliative and populist solutions. The correct approach to ERM II and the Eurozone is

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<sup>8</sup> On this question the answers of financial minister Simeon Djankov to readers of newspaper Segabg are referred at the end of 2010 [www.segabg.bg](http://www.segabg.bg)

<sup>9</sup> The prevailing opinions and studies define the Currency Board as a pro cyclic monetary policy.

certainly not to refrain from legal and institutional changes that are speedy, effective, publicly debated and prepared by experts. From these positions it is necessary to guarantee:

- Financial transparency of the insurance process, of the insurance entitlements and their implementation for all categories of insured, including access to early retirement;
- relieving state social security of all non-specific functions related to administration of non-specific compensations and functions of social assistance;
- Attractiveness and incentives for insurance in the public segment of PInS and extension of the social insurance base (insured persons and insurance incomes);
- The maximum balance possible between insurance contributions and rights of the insured;
- Review of the role of solidarity in the public segment of PInS at the expense of justice;
- Consideration of personal contribution and pension adequacy;
- Limits on preferences and exclusions, narrowing down the scope of people with access to early pensions, including precise definition of the criteria for access and categorization of occupations and activities with heavy conditions of work and the jobs held in the field of national security and defense;
- Maximum computerization of the social security process;
- Incentives for gradual growth of the role and share of the insured persons in private pension funds and schemes;
- Administrative consolidation and subordination of the control bodies, expanded powers of control similarly to the specialized services in Holland, partial outsourcing ;
- elimination of any possibilities for abuse in decisions on disability status and corresponding early retirement, raising the threshold of access to 60-65% disability as it is the practice in most EU-member countries while providing additional guarantees for vocational rehabilitation;
- Higher sanctions and attitude of irreconcilability with irregular behavior on the part of both insurers and insured, pressure for mutual control and restriction of the grey sector on the labour market and in the field of insurance relations.

**Balance of the Issue Department, Social security expenditures Coverage, State Social Insurance and Pension Fund,  
1997-2010 (million BGN and %)**

Year	Banknotes and coins C	Mandatory Reserves of the Banks R	R / MB %	Money Base (C+R) MB	MB / FX %	Fiscal reserves and other deposits G	G / MB	G / FX	Central Bank Deposits B	Foreign Reserves FX	Social Expenditures Pensions, Health, Benefits	Social Insurance Transfer	Transfer and Subsidies to State and Public Insurance (SPI)	Share of Financing Of SPI %	Social Transfer and Subsidies	Pension Fund Transfer And Subsidies S	S / G %	GDP Bln BGN	S / GDP %
2010	8 302	5 812	41,2	14114	55,6	5905	41,8	23,3	5 361	25 380	10079,1 <sup>10</sup>								
2009	8 049	4 897	37,8	12946	51,2	7536	58,2	29,8	4 785	25 267	9359,4	4506,3	3898,2	51,0	3898,2	3370	45,8	66,3	5,1
2 008	9 179	5 006	35,3	14185	57,0	7582	53,5	30,5	3 097	24 865	8156,8	2848,1	2215,8	34,3	2215,8	1962	25,9	66,7	2,9
2 007	8 411	5 783	40,7	14194	60,8	6787	47,8	29,0	2 365	23 346	7059,3	2174,1	1888,6	33,9	1888,6	1400	20,6	56,5	2,5
2 006	6 889	3 594	34,3	10483	60,0	5113	48,8	29,3	1 871	17 459	6331,0	1720,5	1760,8	35,1	1760,8	1400	27,4	49,4	2,8
2 005	5 867	2 484	29,7	8351	57,9	4296	51,4	29,8	1 767	14 415	5579,5	1035,0	1016,5	22,5	1016,5	747	17,4	42,8	1,7
2 004	5 020	2 038	28,9	7058	53,3	4907	69,5	37,1	1 276	13 242	5079,9	922,0	924,7	22,0	924,7	653	13,3	38,8	1,7
2 003	4 264	1 002	19,1	5266	50,7	3860	73,3	37,2	1 255	10 383	4638,8	921,4	907,8	23,4	907,8	514	13,3	34,6	1,5
2 002	3 628	854	19,1	4482	50,1	3198	71,4	35,7	1 265	8 947	4176,8	1021,6	1029,4	28,5	1029,4	705	22,0	32,3	2,2
2 001	3 263	770	19,1	4033	50,8	2762	68,5	43,8	1 147	7 943	3901,3	956,4	605,7	20,6	605,7	700	25,3	29,7	2,4
2 000	2 505	516	17,1	3021	41,5	3284	108,7	45,1	964	7 273	3409,5	615,7	550,4	18,4	550,4	514	15,7	26,8	1,9
1 999	2 083	639	23,5	2722	43,4	2693	98,9	42,9	856	6 272	2668,6	341,0	331,7	13,6	331,7			23,7	
1 998	1 845	578	23,9	2423	47,4	1928	79,6	37,7	758	5 111	2220,0	136,0	166,0	7,6	166,0			22,4	
1 997	1 420	858	37,7	2278	51,6	1302	57,2	29,5	506	4 412			85,2	6,1	85,2			17,4	

*Sources: BNB, MF, NSSI and own estimates*

<sup>10</sup> Total social expenditures at November 2010.

