



Republic of Bulgaria  
ECONOMIC  
AND SOCIAL COUNCIL

# **OPINION**

**on**

## **PROBLEMS OF THE PENSION SYSTEM IN BULGARIA**

(on its own initiative)

Sofia, 12 December 2006

The 2006 Operation Plan of the Economic and Social Council envisages the working out of an Opinion at its own initiative on the theme of: "Problems of the Pension System in Bulgaria".

The President of the Economic and Social Council has assigned the Standing Commission for Budget, Finance, Insurance and Social Security to work up the opinion.

Mr. Dimitar Manolov – was appointed Rapporteur.

The Commission prepared the draft of the opinion and presented it for approval by the plenary session.

The Economic and Social Council approved the present Opinion at its plenary session held on 12 December 2006.

## I. CHANGES ACCOMPLISHED

1. The pension reform that Bulgaria has undertaken *since the beginning of the year 2000* is **in response to the new financial, economic, demographic, public, political and social realities**, whose maturity at the end of the last century confronted the country with the urgent need of deep changes, adaptation and modernization both of the legislation and the architecture and functioning of the pension system.

2. As a whole through the legislation of the pension reform **the country has made decisions targeted at achieving a balance which will guarantee the realization of the social goals of the pension system as well as the attainment and the supporting of financial stability and viability of the system**. Under the conditions of financial supervision by the international institutions and because of not fully free will, the choice of a three-pillar architecture and the correlation between the pillars therein, with an accent on the first public solidarity and cost-covering pillar, this choice is in compliance with the concrete conditions corresponding to a great extent to the traditions of the Bulgarian social insurance. With a view to the fact that the public solidarity cost-covering systems still continue to provide the main pension protection in the European Union /excluding the United Kingdom, Ireland and the Netherlands/ **Bulgaria has fitted into the European context**. However the existing second pillar in the EU /the so called professional pensions/ is something too different from what is called a second pillar in Bulgaria.

3. The concrete measures and policies set forth in the legislation of the reform – financial autonomy and rigid financial order, higher requirements for admission to the pension system, restricting the early retirement, improving the connection between the individual contribution and the size of the pension compensation, improving the control on the adherence to the legislation, involving all employed persons – constitute the **measures and policies that in one or other extent are taken up by all countries** which are preparing reforms or have already completed such ones.

4. The realization of the pension reform is encumbered by the long **absence of specially worked up compensating measures and employment programmes**, as well as by its “overlapping” with reforms held in other extremely hard and important areas /privatization and restructuring of the economy, healthcare, and etc./.

5. For the period of the pension reform’s functioning Bulgaria has undertaken impulsive and casual resource-consuming regulatory **changes, which have deviated the country from the scenario and parameters set up at the start**, including in relation with other risks of the financial consolidated state social insurance due to which the achievement of the financial balance /liquidation of deficit/ planned for the period 2005-2006 has not been attained. ***The own revenues of the system, sacrificed in the name of the competitiveness of the economic subjects, have remained permanently uncompensated and no longer financial balance can be achieved either in long-term aspect.*** /See Appendix No 2/.

6. The application of a new pension formula, of a mechanism for a yearly update of the pensions, of new kind of benefits and casual additional payments to the pensioners /usually as at Christmas/ **have sensitively improved the nominal amounts of the pensions, but they still lag far behind from the adequate level for the predominant part of the pensioners.** A great concern causes the marked falling behind of the so called old pensions i.e. the pensions of the persons in quite advanced age.

**7. The start of the supplementary compulsory pension insurance has been successful** whose characteristic features are the governmental control, stable management and coordination with the public pension system. The representatives of the trade unions and the employers have received a relatively significant role in the implementation of the regulations, the execution and the tracking of the policies including the guarantee of the rights for the employed persons.

8. in the light of the pan-European objectives and values **the beginning was laid for achieving a straighter connection between the strategy and the policies in the sphere of the pensions and the National Employment Operation Plans** with a view to raise the employment level, restrict the inflow to the early retirement schemes, increase the incentives for prolongation of the occupational life and to set the pension systems on stable financial foundations, including for the creation of public reserve pension funds.

9. The analysis of the experience so far gives grounds to make the conclusion that **there is room for certain regulatory modification** in respect of the situation in 2006-2007 and most of all in relation with the commitments ensuing for the country from the European documents in the area of the pensions and the social involvement – to guarantee well-deserved life for the elderly persons, the pensions /both the current and the future ones/ should not be a generator of poverty and they should match the new individual needs and *what is the most important*, the pension systems must be financially healthy, autonomous and long-term stable.

## **II. THE BULGARIAN SYSTEM AND THE OPEN METHOD OF COORDINATION**

### **A. Supporting the financial stability of the pension systems**

The situation and the development of the pension reform in Bulgaria are pushing forward the principle of financial sustainability and hardiness, stability and long-lasting of the pension system in distinction to the arrangement of the general principles for the reformation of the pension systems, determined at European level where the first accent is “the adequacy” of the pension rates. Though the pension amounts in the country keep staying critical being the lowest among the member-states, the situation and the perspective of the system deficit, the dependence coefficient and the generated public attitude and tuning that the contribution payments are a burden and an obstacle for the development of the economy, outweigh and pre-condition the support extended to the pension system as a first priority.

1. Achieving and keeping up high economic results can contribute substantially to the support of the pension system. The growth of the gross domestic product (GDP) should allow not only **to drop down unemployment but also to bring about the abrupt improvement of the participation in the labour market**. It is the biggest challenge to cope with this situation also demanding **coordinated operation programmes** which will pursue those exact objectives as well as supplementing the legislation with the recommendable for Europe special incentives for keeping the elderly employees at the labour market, respectively **reducing the standards of encouraging the early retirement to exceptions**.

2. The supporting of **an optimal relative share of the expenses for pensions from the gross domestic product** should be a basic instrument for the effective management of the funds' value set aside for pensions in order to enable the achievement of the parameters set in advance for improving the quality of the pension protection in compliance with the pan-European objectives and policies subject to the adequacy of the pensions in mid-term and long-term aspect.

3. The keeping up of financial viability and stability of the pension system shall obligatorily go through **a careful assessment of the impact, respectively of the risks when undertaking regulatory changes**. This is particularly valid in relation with decisions leading directly or indirectly to a reduction of the own revenues of the state social insurance, respectively the pension system. In this connection it is necessary to make **a sanguine and impartial analysis of the lasting impacts from the reduction of the contribution payments** concerning the financial viability of the pension system in mid-term and long-term aspect. Their negative nature can be easily traced in the actuarial estimates and assumptions till the year 2050 /Appendix No 2/. The data show that the reductions of the contribution payments made so far in combination with a certain return to liberalization of the expenses in the system will seriously and permanently disturb the relations – the State Social Insurance (SSI) balance, subsidy from the Central Republican Budget and financial autonomy of the National Social Security Institute (NSSI) and they will also deform the nature of the social insurance as a process of using considerations in conformity with contribution. **In this factual situation the financial autonomy and management of the system are put to the test and therefore they need reconfirmation /both in political and regulatory aspect/. The main role and the portion of the public solidarity first pillar in the pension protection of the Bulgarian people desperately needs such reconfirmation.**

4. An important trend for achieving the needed financial stability is the further **increase of the scope of the socially insured employed persons** and advantageously the scope of the farming producers and agricultural workers in combination with incentives for a longer participation in the social insurance process and progressive increase in the requirements for an access to a pension.

5. Getting under control a part of the financial challenges which the pension system has already confronted with /high and long-lasting deficit/, and particularly the increased demographic pressure as a result from the getting on in pension years of the aged cohorts from the end of World War 2 can be overcome by **the setting up of a demographic reserve fund**. Thus Bulgaria, besides enriching the national instruments for rendering support to its pension system, will fit into the EC recommendations for the creation of similar funds with a view to maintaining the financial viability of the system.

## **B. Adequacy of the pensions**

Under this title according to the European documents in the field of the Open Coordination Method (OMC) – pensions and social integration, high and ambitious pan-European objectives have been indicated, the achievement of which the states have to secure with their own pension strategies. *The realization of these goals and values* undoubtedly represent a big challenge to the further development of the Bulgarian pension reform. ***The future actions and measures in relation with the pension rates for sure will have to take them into consideration all the more that Europe intends to introduce also assessment criteria for achieving them.***

6. The improvement and specification of the connection: “right” – in the occasions of objectively occurred risk /illness, maternity, old age and disability in particular/, and “refusal” – in case of formal and malevolent “adjustment” to the legislative requirements shall be a pre-condition for further actions and steps in favour of the adequacy. The improvement of the latter in any case will go through ***the further regulatory optimization of the solidarity and effectiveness of the law implementation in the pension system for achieving fuller social justice.***

7. The pension formula is a working and flexible instrument for the adequacy improvement of the pensions paid. **Achieving a higher coefficient of income substitution** including also through a differentiated percentage for each year of contribution period in the pension formula when staying in the labour market over the lawful age and length of service shall be a main priority when using it. The commitments of the country for the execution of the Lisbon Strategy recommendations for a longer participation in the labour market and for higher incomes after retirement shall be also a crucial argument for actions in this direction.

8. Within the measures for improving the adequacy of the pension system and in compliance with the engagements assumed towards the rationalized Open Method of Coordination, Bulgaria shall have **to guarantee that the elderly people are not in risk of poverty and that they enjoy a worthy way of living**, as well as that they can avail of the economic welfare of their country and participate actively in the public, social and cultural life. This ambitious objective cannot be realized **without targeted and supplementary measures and policies which would contribute to a more intensive improvement of the pension rates**. In this context the role and the importance of the ingrained tradition for paying up one-time Christmas benefits stand out, which unfortunately is not sufficiently well used as

a flexible tool for a real raise of the pensioners' incomes. Using it as **a specific instrument** for improving the adequacy of the pensions with the options of a differentiated approach, that it contains, shall be able not only to decrease the general risk level of poverty among the pensioners, but will also strongly help the overcoming of the discrepancies between the pension rates, granted before 1 January 2000 and following that date.

**9. A precise mechanism for determining a “ceiling” (top limit) on the pensions** would work in the direction of an improved adequacy of the pension payments that needs objectivity in order to be “individualized” to the maximum possible extent. The smooth transition from a “ceiling” on the pensions to a regulation of the insured income /i.e. restriction at the entrance of the system and releasing at the exit/ appears also attractive because of the double effect – to stimulate the participation in the compulsory pension insurance and release funds for the supplementary voluntary pension insurance. In this context **the problems for the methodology in defining the levels of the minimum and maximum insured income shall be of particular significance**, especially from the point of view of the after-effects from the reliefs “at the entrance” (at the admission) /the agricultural producers can insure themselves at 55 lewa which brings them symbolic pension rights and engages too much the solidarity in the pension system and in the state scope as well/.

**10. The relationships and the correlations between the considerations of the two compulsory pension pillars** are of particular importance for the adequacy of the pensions. Achieving the balance and the correlations set by the reform objectively demands a precise implementation of the actuarial methods and analyses for **the evaluation and defining of the social insurance contributions** and first of all of their impact on the revenues in the public solidarity system. The currently valid social insurance contributions to the professional pension funds require a particular attention and revaluation in relation with the different categories of the working concerning the different periods of paying the fixed-term pensions in order to avoid a possible conflict between the rate of the fixed-term pension and the one of the basic life pension.

### **C. Modernization of the pension systems in response to the changing needs of the economy, the public and the individuals**

The objectives are inherent to this main trend in the Open Method of Coordination that **the pension systems will not impede the mobility of the labour market within the frames of the member-states as well as beyond the border**; for ensuring **security and guarantees for the pension rights of the citizens occupied in non-standard forms of employment** /partially employed, by standing for those absent, temporary employed and etc./; for encouraging the self-employment and strictly observing the equal treatment of women and men in accordance with the EU law. It also involves the requirements for improving the transparency of the pension systems in order to preserve and develop the long-term trust of the people to the pension systems; for searching the widest possible consensus when undertaking regulatory changes and of course, for the implementation of

an effective monitoring on the pension policies and reforms with the active involvement of the social partners.

**11.** An obligatory element in the modernization of the system is **the mastering of the further reproduction of the differences in the coefficient of substitution and pension levels with the women and men.** The achievement of this result in the context of the Lisbon Strategy shall obligatorily go through **adequate policies and measures of the labour market** for an equal chance and equal treatment as well as through the extremely unpopular but inevitably smooth and gradual equalization of the requirements for an access to a pension /contribution period and old age/. In the same context is the solution of the problems related to the equal treatment of the women and men when determining the rates of the supplementary pensions from the second compulsory pension pillar /for equal capital – equal pension/.

**12.** In order to achieve better transparency and with a view to scale up the trust in the pension system, the Bulgarian institutions, *first of all* the politicians and the social partners will have to make the efforts **to learn the cyclic re-considering, giving new meaning to and outlines of the already adopted and to a great extent practically realized parameters, thus circulated after the start of the reform.** The practice with each consecutive law for the budget of the state social insurance to modify the changes of the preceding year will contribute neither to strengthen the confidence nor to the transparency in and of the system nor for the achievement of a broader consensus. In any case, in the future it will be necessary to make regulatory changes and supplements both due to domestic need and due to the European engagements to the OMC and the fulfilment of the 11 common goals. However, all this is to be done on the basis of serious preliminary preparation referring to arguments based on the actuarial analyses and estimates, provided solid long-term perspective in relation with the assets and liabilities and considerations of the system, the way it is recommended by the European Commission (EC) and its bodies.

**13. The constant monitoring on the policies pursued** during the reform with the corresponding analyses and assessments comprise the essence of the process for the updating of the pension system in response of the changing needs of the economy, the public and the individual person. For this purpose it would be good to use the European experience **in the setting up of a constantly operating commission /committee/ of professionals from the respective institutions, administrations, NGOs and from the organizations of the employees and of the employers.** This commission or committee should have enough powers and responsibilities regulated in a way that will officialise and validate the product of its activity /annual report, for example/.

**Appendix No 1****ANALYSIS OF THE PENSION SYSTEM IN BULGARIA****INTRODUCTION**

For the purpose of this opinion the materials and analyses presented through the Economic and Social Council of the republic of Bulgaria by the Ministry of Labour and Social Policy, the Agency of the Disabled People, the Bulgarian Association of the Companies for Supplementary Pension Insurance have been studied. The basic formulations of the Appeals of the European Commission, the opinions and reports of the High-level Groups /ministers of labour and ministers of finance and economy of the member-states/, of the European Councils /Barcelona, Lisbon, Goteborg and Laaken/ as well as the ones of the European Economic and Social Committee related to the problems and the vision for the social protection as a whole and the pension systems in particular, have been also taken into consideration.

***1. The global context***

1.1. For decades now the main sign marking the development of the civilized societies has been the setting up and functioning of social protection systems guaranteeing fundamental human and social rights, systems which have a substantial contribution so that the states and peoples can live in peace and prosper. The social rights, the feeling of justice and security make the cohesion of the society and build confidence and compassion without which the state management in every country could hardly achieve a successful and high economic development. It is no accident that not long ago one of the main lines of rivalry and competition between the two political and economic systems was held on the social protection terrain. And it is no accident either that the principles of the social cohesion and the solidarity have been written in the Treaty for the European Community.

A key element in the general structure of the social protection systems are the pension systems, which by providing the elderly population with incomes respectively economic autonomy, perform the role of a basic pledge and instrument in maintaining the social cohesion and solidarity in the public.

1.2. For the last twenty years the economic and demographic processes have strongly changed the characteristics and perspectives of the environment in which the pension systems function in most of the states where the latter exist. Potential and real risks have been identified which endanger the supporting of the pension systems and hence their healthy future. In addition the evolution in the needs of the society and of the single individuals has generated new pretensions to the acting social protection and the pension systems in particular.

1.3. Thus the undertaking of strategic, adequate and effective measures for the preservation and the sustainable development of the pension systems was materialized. The road towards

ensuring a lasting future of the social systems and above all of their pension component has occupied a central position on the agenda of the civilized societies while the strategies for the reformation of the pension systems have turned into central debate and intrinsic element of the idea for the general development of the states including the most advanced and rich countries.

## **2. The national specifics**

2.1. As early as the start of the deep socio-political and economic transformations in 1989 the warnings about the “outdating” of the Bulgarian pension system were noticeable and tangible – the possibilities for social insurance of the persons privately employed did not comply with the personal activity that had come into being after the adoption of Degree 56; the formula for the pension rates set in the acting pension legislation “was working” only with one of its elements; relatively strong wage-levelling standards /pension threshold and ceiling – bottom and top limit/ were in force while the incentives for staying in the labour market after acquiring pension rights became still more harmful and senseless since they practically acted in favour of the too liberal provisions for an access to a pension and thus the connection between the personal “contribution” and the rate of the acquired pension was eroding. The general disapproval of the existing pension system was getting power, scope and speed.

2.2. The headlong developing processes of the deep socio-economic, social and political restructuring after the beginning of the transition have intensified the existing and pushed to the surface new challenges confronting with the functioning and stability of the pension system in Bulgaria. The country was experiencing a deep crisis, a boom of price shocks boom and inflation processes, dangerously growing unemployment, bankruptcies, expanding “underground” economy, political fights and deficiency of strong will /courage, determination/ for a radical pension reform.

2.3. It did not take long for the negative demographic characteristics to come up – sharp decline in birth-rate, growth of death rate and the children’s one in particular. The negative natural population growth was reported as early as in 1993 and later it was confirmed. An additional stroke on the still worsening demographic picture was done by hundred thousands mostly younger people leaving the country.

2.4. The enormous external indebtedness and the sharp need of financial resources for getting the existing systems run on new rails provoked the interference of the international financial institutions /the World Bank and the International Monetary Fund/, which has developed into an active surveillance and decisive, not deprived of institutional interest, role when determining the basic parameters of the pension reform. Hence, readiness is available for technical, experts’, and financial /gratuitous but also extended loans/ aid for its development and beginning. The introduction of the Currency Board additionally tightened the financial vice and restricted the “manoeuvre margin” when programming and implementing the pension reform.

2.5. The going processes and delayed actions determined not only the necessity of reforming the pension system in order to update and correct some of its postulates and parameters,

but following the grave crisis of 1996-97 when it used to pay pensions of several dollars, demanded radical actions for its survival in a long-term aspect.

### **3. The beginning**

3.1. The first steps for the reformation of the pension insurance were made as early as the first years of the transition period. They were realized within the framework of the existing pension legislation as a reaction to the coming up and constantly varying problems of the pension system which were related to the going on economic, financial and demographic processes. Alongside with this, those first changes had laid the grounds for a more thorough and complex social insurance reform that would be in accord with the new social relations established in the country and which was completed at the end of 1995 by the adoption of the Social Insurance Fund Act. These first modifications included:

- updating /yearly/ the pensions in comparison to the abrupt rise of living maintenance (1992);
- increasing the social contribution payments including for those working under the provisions for the first and second category of labour (1993);
- enlarging the range of the insured persons beyond the area of hired labour (1993);
- separating the social insurance system from the state structures and the governmental budget by the creation of a “Social Insurance” Fund” (1995) and the setting up of the National Social Security Institute as an autonomous institution;
- introducing the principles of the tripartite management of the social insurance funds (1995) and involving the social partners in the management of the national social insurance system;
- steps towards a straighter connection of the contribution payments with the social insurance contribution of the beneficiaries – a personal social insurance contribution at the amount of 2 percent was introduced (in 1997);
- indexing and compensating the pension rates in order to protect their purchasing power against the dynamic inflation processes (1997);
- beginning of building up an information system /via a loan from the World Bank/ which will store the social insurance “history” of the insured and the employers (a system for preliminary collection of data – 1997).

3.2. These first reformative steps were both useful and of good results. However they were predominantly of an organizational nature, were driven to modifications of principal character in the state social insurance and not focused on the pension system. There rather prevailed the reactive (and not the pro-active) approach in looking for more natural and firsthand including also political effects. The lack of sufficient political will and courage at that time as well as ambitious, well-grounded, well-argued and established with consensus strategy for the social insurance reform, including the pension one, had also conditioned similar approach. The attempts of creating such a strategy then got as far as the working up of the so called “White Book”, which was not deprived of merits but it did not developed into a concrete plan for practical actions.

3.3. In response to the going processes and undertaken modifications, and also as a result from the public debate and the demands targeted at the pension reform in 1994, the supplementary voluntary pension insurance, based on a capital principle and of private nature, came into being in Bulgaria. Though without any normative regulations available of its own, this new kind of social insurance has quickly gathered speed and cleared its path whose configuration consequently served as a basis of the new legislation devoted to the supplementary pension insurance of the capital type.

3.4. The radical reforming of the social insurance system with an absolute accent on the pension reform was realized by the drawing up and adoption of a Compulsory Social Insurance Code. It was given wide social publicity and worked up with the participation of representatives of almost all strata concerned, and the social partners in particular. The solutions involved therein were the result of political decisions, expert's assessments, studies and analyses of the international experience, from estimates and actuarial models and forecasts, from more or less delicate pressure on the part of the international financial institutions and not in the last place from a reasonable compromise on the part of the main "players" in the social insurance – the trade unions and the employers. That act was enforced on 01 January 2000 and practically it appears to be the main instrument for carrying out the pension reform.

3.5. In relation with the pension system the new social insurance legislation has introduced radical, to a great extent restrictive and very severe, because of which too unpopular, but necessary to inevitability, measures which have to realize a triune objective – preservation, consolidation and modernization of the national solidarity (public solidarity) pension system, by smooth overcoming the tension between the accrued pension rights and the financial possibilities for satisfying them, varying and supplementing the architecture of the pension system by new elements – private capital pension schemes.

3.6. The new social insurance legislation (in force since the year 2000) was targeted at healing out the most pronounced and cost consuming weaknesses of the current one, which have also generated the main problems in the pension system:

- chronic financial deficit and a future long-lasting financial instability;
- the low collection rate of the contribution payments and the mass circumventing and avoiding the social insurance obligations;
- too liberal provisions for an access to a pension and particularly in relation with the employed under the provisions of the first and second category of labour enjoying early retirement rights;
- high social burden on the working generation;
- disturbed social justice because of undue dose of solidarity and generosity of the rights;
- low pension rates and especially those of the former granted pensions in which practically the connection with the basic remuneration was completely interrupted;
- absence of alternative and supplementary elements varying the pension protection;
- growing distrust and nihilistic attitude to the social insurance as a whole and towards the pension system in particular.

3.7. For the creation of opportunities for the settlement of the above-stated problems the new legislation has introduced some absolutely new as well as modernized and updated, basic regulatory formulations by means of which:

- A new architecture of the pension system was set up, based on three pillars and also combining a governmental involvement and private initiative as well as the compulsory with the voluntary basis;
- A precise normative regulation was introduced about the personal scope of the pension system, the controlling measures were updated, the requirements and sanctions in infringements have scaled up;
- The contribution payments were assigned in fixed proportions between the employers and employees;
- The social insurance base was extended (all incomes from occupational activity) and maximum and minimum amount of the insured income was set;
- There were introduced minimum insured incomes by economic activities and qualification groups of the professions as well as an obligatory registration of the employment contracts;
- An option was given to anyone working under provisions of the first and second category of labour to choose autonomously a professional fund for social insurance in the event of an early retirement;
- Those born after 1959 were extended the chance of insuring themselves in a universal fund with a right of a second life pension from the accrued funds in their individual account;
- Every Bulgarian national /including also the unemployed/ was given the opportunity for self-insurance in a voluntary pension fund by taking advantage of a tax relief;
- The connection improved considerable between the amount of the received insured considerations by the participation and contribution to the social insurance system. Simultaneously the guarantees for the rights of the insured have also got to the better.
- A new pension formula was introduced whose basic elements reflected both the personal contribution of the insured and the situation of the own receipts of the pension system. Alongside with this, flexibility was set in it, which gives a possibility for an “adjustment” (matching) with a view to the perspective offered by the second compulsory pillar as well as for the objectives of improving the quality /the pension rates/ of the protection;
- State supervision was established on the activity of the second compulsory and the third voluntary capital elements of the pension system. The social partners have been involved in the control on the situation and operation of the funds by setting up trustee boards.

#### **4. The Reform 2000 – 2005**

##### **A. The economic context**

4.1. For each pension system the rates of the economic growth, the employment/unemployment level, the incomes, the inflation, the parameters and the tendencies of the demographic picture have a key importance. Therefore the presence or absence of specific accompanying measures or coordinated strategies in the indicated areas precondition the successful start and development of any pension reform as well as the rates for the

achievement of the preliminarily set and estimated parameters and goals. The Bulgarian pension reform has not been equipped with “supplementary” mechanisms in the above-stated areas. The actions taken up in these spheres were mainly subordinated to the general context of the transition to a market economy and the related restructuring of all social systems as well as the mastering of the effects thereof. The thus reforming pension system which was dragging its own financial burden but was functioning, turned out to act as a buffer to the effects and the negatives /some of them had been even assigned to it/ of all other reforms, that had been carried out /structural, health, military/. However, the pension system and its reform have been enjoying the special attention of the authorities and a guaranteed, though minimally needed, financial support by the governmental budget.

4.2. As early as in the year 2000 /the first year of the reform/ the national economy realized an accelerated growth. At hand there was also a certain progress in the restructuring of the economy in the country. The same year the real growth of the gross domestic product (GDP) was 5,8%. In 2001 the growth of the gross domestic product was slightly lower – 4%, and the explanation is to be found in the changed economic conditions after the terrorist attacks in USA on 11 September 2001 and the decrease of the investments growth on the international scale. In 2002 the GDP growth was again – 4,8% real increase in comparison to 2001, where a stable tendency of consolidating the rates of the economic growth was formed after the implementation of the Currency Council. During the next three years – 2003, 2004 and 2005 – the tendency kept the same and the real GDP increase was respectively 4,5%; 5,6%; and 5,5%.

4.3. The average annual inflation for the same years /2000 – 2005/ marked a sustained drop – from 10,3% in 2000 to 7,4% in 2001 and 5,04% in the year 2005.

4.4. At the very beginning of the pension reform the labour market has extremely grave indicators from the standpoint of its needs – the year 2000 downturn of the employed by 3,4%, in comparison to the preceding year, and 18,4% unemployment. It was only in the third year of the reform – 2002 that it started to turn the tendencies and the unemployment level marked a slow decline in order to get to 10,52% at end-2005. The second half of the period was marked by a revival in the labour market policy, aspiration for transition from passive social protection of the unemployed to providing employment and adequate qualification training. A differentiated approach was used to the different social groups of unemployed persons in compliance with their concrete qualification and needs. Special target-driven programmes were made for subsidized employment including a programme in support of persons affected by the new provisions for an access to a pension having lost their jobs – “Assistance for retirement”.

4.5. The development of the incomes in the country measured by the dynamics of the average work salary for the country for the six-month period marked a 42,2% nominal growth while the real one was 26,1%. The growth of the minimal work salary /52% real expression/ is overtaking and in 2005 it marked a 19 percent real growth. Because of the low levels of the work salaries in the country at the beginning of the period, those impressing at first sight growths did not improve drastically their levels.

4.6. If the comparatively high rates of economic growth, the low inflation and the scaling up income were facilitating the rotation of the pension reform engine, then the consequences

from the structural reform of the economy, from the reforms in the education, the army and the healthcare, were having just the reverse effect – increasing the number of the pensioners and the unemployed, deteriorating the health situation of the population and many other effects aggravating the social insurance and particularly the pension expenditures.

### **B. The demographic context.**

4.7. During the period discussed /2000 – 2005/ the basic demographic indicators followed the unfavourable trends that had permanently established for the last 15 years – decrease of birth rate and rise of death rate. As a result of these trends the natural population growth since 1993 has been negative and it has an extremely unfavourable influence on the demographic structure of the population. In 2005 the coefficient value of the natural population growth was minus 5,3 per thousand and it got to worse in comparison with the year 2000 by 0,7% points. The intensive emigration whose rates are not going down should be added to this picture. There are different assessments of its range but there are no sources to contest the fact that over 750-800 thousand Bulgarian nationals, the larger part of whom are in the age of employability, have emigrated from the country for the last 15 years.

The structure of the population during that period was also changed. The population in the capacity to work as at end-2005 was 4814 thousand persons or 62,4% of the total population. That category of the population had increased by 32 thousand persons in comparison to the pervious year. The population over the employability age in 2005 was about 1762 thousand persons. For a year it dropped down by 43 thousand persons. These data are a result not only of the natural movement of the population – the death rate, but also because of the change in the age limit for retirement. That is why a part of the incapable to work population has transferred to the employable population. A permanent and a very disturbing tendency of decrease has outlined among the population below the age of ability to work. In comparison to the year 2004 the decrease was 31 thousand and at end-2005 this category counted 1143 thousand persons. Totally for the six-year period of the reform the population in the under-employability age dropped down by more than 160 thousand persons, while the population in the employability age increased by about 140 thousand persons including as a result from the gradual scaling up of the pension age. These data and tendencies confront the further development of the reform and not only it with an extremely grave challenge.

### **C. The political context**

4.8. The governing political coalition, which assumed the political responsibility for working up and implementing the social insurance including the pension reform, has managed to achieve a remarkable social consensus and public support in relation with the start-up parameters of the reform, though just before the immediate parliamentary reading it has made slight concessions from some preliminarily specified and estimated parameters, including such ones extenuating the restrictions. As a whole this part of the political spectre continued to render their support for the reform. The political opposition of 1999-2000, of course, was critical in principle and monolithic when abstaining from a categorical position while voting both “pros” and “cons”.

4.9. The political forces that succeeded the government starting the reform generally speaking have declared and demonstrated their support for the social insurance reform and the pension insurance. Even significant measures have been taken up for re-codification of the newest social and pension insurance legislation. Additional measures were also initiated for improving the better collection of the contribution payments, the control for adherence to the legislation and bettering the social insurance protection. However, the legislation of the pension reform used to be and has remained the main territory for searching quick and efficient political dividends.

4.10. The Bulgarian pension reform as whole enjoys an appropriate support in international aspect. The positive responses of the World Bank and the International Monetary Fund are understandable due to their specific role in this process. The International Social Insurance Organization (ISIO) has also given a positive estimation to our pension reform. The 2001 and 2003 reports of the European Commission identified the pension reform as one of the areas where the greatest progress was made. The assessment of the International Labour Organization (ILO) is slightly more delicate. The ILO experts have remarks to the decision of reducing the insured receipts of the public solidarity first pillar though being insufficient in order to forward them to the capital pillar as well as to the missing "sex neutrality" in the general rules, still quite scanty, for determining the pension from the capital schemes. Many states that have started their reforms after us are taking great interest and desire to use our experience.

4.11. Because of the sensitivity of the theme, the internal political as well as the social consensus on the reform in the social insurance in Bulgaria is too fragile. Its restrictive character, though objectively forcible, gives grounds to the affected aged cohorts to demonstrate permanent discontent. The situation of the labour market and mainly in relation with the persons over the age of 50 and 55 has been constantly generating pretensions and discontent with the restricted access to pensions, which no doubt represent a fully guaranteed income nevertheless it is not very high. Therefore some politicians and political formations are very much tempted to manifest strong social sensitiveness and commitment by criticizing the pension reform. This is particularly valid in the period before and immediately after elections. In such cases sometimes it even comes up to denying the reform or its fundamental principles and to assuming unfeasible promises, which besides generating expectations and attitudes to the detriment of the main objectives of the pension reform will neither contribute to strengthen the trust in the national social insurance systems nor will support the cultivation of higher insurance culture in the population. Politicians from the whole political spectre have suggested corrections in the Social Insurance Code leading to an increase of the pensions or to a reduction of the contribution payments or to preferential regimes for the social insurance of some categories or both. Therefore quite a large part of them have been realized. The positive motives in these cases should not be contested but the concern for the financial and moral after-effects, for the social peace, for the balance of the "Pensions" Fund, for keeping the longevity of the pension system should not be neglected. However they are losing the battles for the time being. A whole series of modifications in the parameters and formulations initially set in the legislation /at end-1999 and the beginning of 2000/ in relation both with the access to the system and with dimensions of its own receivables

and the control for adherence to the legislation were realized /referring to the main argument that the citizens of an age close to the pension age cannot find a job and do not have any earning/, and as a result the obligations with growing financial burden for the pension system did not fit for a long time into the initial estimates and expectations for the financial stability of the “Pensions” Fund. Instead of the planned for 2006 – 2007 balancing of the budget of the “Pensions” Fund of the state social insurance and the nullification of its deficit, the actuarial estimates show today an irretrievable misbalance in the next several dozens of years /See Appendix No 1/. In fact the chosen new model of social insurance is not to be found in the basis of the critics to the reform in the social insurance but rather the consequences from the unfavourable impact of the factors outside the pension system even outside the social insurance system. However it is often to link these unfavourable factors and after-effects with the pension model and with reform without presenting very reliable arguments.

## **5. Outcomes – lessons**

### **A. First pillar of the pension system**

5.1. **Strongly restrictive in relation with the pension amount** in percentage compared to the lost income and in relation with **the growing requirements for an access** to pension – this is the most summed up expression and the basic feature especially in the first years of the reform when the correlation between employed and pensioners was still too disadvantageous.

5.2. On the other hand, however, the comparison with the former pension system particularly in its situation some ten years prior to the reform both by effectiveness and by justice is even so in favour of the new reformed system. The first pillar is universal and encompasses all groups of employed persons regardless of the employment nature and the type of the incomes received. There exists and further develops the connection between social insurance contribution and pension amount /though this objective of the reform often is presented as its shortcoming because it is clear that it is more beneficial to choose only 3 best years out of one’s whole occupational service than to have the system “tracking” you throughout your whole working life/. The insured of higher insured income and longer participation definitely will receive higher pensions. There has already been an improvement in the differentiation of the pension rates. Slower than the anticipated, however the so called privileged groups have been restricted and “transferred” (except for the military people and the police) to the second pillar where they could realize their right of an early retirement and fixed-term pension received from the professional funds. Due to the low but still effective retirement age the presence of privileged groups which keep taking advantage of the former more liberal provisions and especially because of the easier misused access to disability pensions, the pension reform cannot achieve yet the complete and proper connection: “right” – on the occasion of the objectively occurred risk /old age and particularly disability/, and “denial” – in formal and in bad faith “matching” to the lawful requirements. It is still in a process of a transition to such exactness.

5.3. The relative autonomy of the system both institutionally and financially has been preserved in the pension reform. It is transparent – the management of the social pension

fund is tripartite while the universal and the professional funds have trustee boards whose members are representatives of the employees and the employers. The voluntary pension funds have also analogous bodies with identical composition – consultative boards. This way after its reformation the Bulgarian pension system has also met the established international standards and approved practices that are valid for all civilized societies.

5.4. The execution of one of the founding and original objectives of the reform is carried out successfully – to increase the range of the insured employed persons by matching the incentives for longer participation in the insurance process and the progressive increase of the requirements for an access to pension. The number of mechanisms /including after the initial start/ introduced for improving the scope of the insured persons and the incomes on the basis of which they are insured /the registration of the employment contracts and the minimum insured thresholds by economic activities and profession groups – valid since 01 January 2003/ have proved high effectiveness. They have enriched also the control instruments for adherence to the social insurance obligations. Thus only for the first year of their implementation the collection of the contribution payments has raised by 13,2% compared to the previous year and over 250 thousand employed came out to light which brought about an increase in the number of the employed persons. Measures of similar nature however should be searched for and applied especially in the context of the European policies and the common goals related to the stability and the future of the social protection systems.

5.5. Still further in the direction of improving the scope of the insured a flexible and preferential regime has been implemented by the new legislation concerning a group, quite passive as regards social insurance and difficult to be subject to identification and control, such as the agricultural producers occupied only with this activity. By way of an exception from the general universal approach for this group the minimum amount of the income to pay the contribution payments was fixed to one fourth of the minimum insured income for the self-insured persons. Apart from this they have also a possibility to pay the lump sum of the contribution payments by 31 March of the next year in case they pay social insurance for a pension only, while the regulation for all other persons is that the payment should be effected on a monthly basis. Similar measures and policies in relation with this group should be carried out and varied in the future as well, especially in the context of the European membership of the country. They should be obligatorily combined with a more intensified and stricter control linked also with the possibilities of assisting this type of activity.

5.6. Though the reforms in principle and those of the pension systems in particular are an expensive undertaking by understandable reasons, especially during the first transitional years, the Bulgarian pension reform has caused neither difficulties nor obstacles for maintaining healthy public finances in the country. The total expenses for pensions, which comprised 8,04% of the GDP in the year prior to the start-up of the reform, slightly went up to 9,4% during the first year and by too slight fluctuations they kept the level of 9,0% till 2005, while in 2006 and 2007 they dropped down even below this level. The comparisons with some other European countries show that the relative portion of the expenditures for pensions in the gross domestic product of Bulgaria is quite lower /Austria – 14,5% of GDP, Italy 13,8%, Portugal – 13,3%, France – 12,1%, Germany – 11,8%, Finland – 11,3%, and

etc./ The standard explanations on this issue are that Bulgaria has been under the Currency Board regime since 1997 and the improvement of the living standard of the people, including of the pensioners, is still a priority but in order to have it realized it is necessary to invest in reviving and stabilizing the economy and in increasing the investments share in the GDP as a basis for an accelerated economic growth. It should not be omitted that a factor for stabilizing the economy is the revival of the domestic seek and demand rate, which in turn goes through scaling up the incomes of the population. And in the case with the pensioners – the point is about a large part of the population, which is of strongly limited potentials to participate in the market of goods and services. So the percentage value of the gross domestic product set aside for pensions is a matter of the pension system perspective that should be given a permanent political and even legislative solution in order to achieve an effective and systematic management of this perspective.

5.7. The new formula used to determine the pension rates was estimated to guarantee a minimum of 40% substitution for the lost occupational income. The data provided by the National Social Security Institute (NSSI) show that the chosen formula generally speaking meets this task. The coefficient of the incomes' substitution, measured by the correlation of an average pension – average work salary for the country, on gross basis, with the pensions for contribution period and old-age it moves between 35 and 40 percent. Of course, for certain professions and/or groups of insured persons this coefficient is higher. It should be taken into account that the pensions are not levied with a tax. The coefficient determined on a net basis is also higher – from 48,1% in 2000 it reached 51,3 in 2005. However it should not be omitted that two thirds of the pensioners in the country receive a pension below the mean one or about that amount as well as the fact that an enormous part of the insured under the new legislation will rely only on the pension from the first public solidarity pension pillar. On the other hand, the rates of all the pensions, including the maximum one, do not provide any guarantee of the adequate security for living or sufficient consumer's activity. Therefore the main critics towards the pension system both on the part of those "within" the system and of its future "users" are mainly in relation with the pension rates. And though there are many more and different reasons for this situation and all of them cannot be referred only to the formula for determining the pension amount, it has been already established that the substitution rate of the lost occupational income set in the formula has been too minimized. That is why the new pension formula or rather the "cashing" of one of its elements /such flexibility is available in it/ should be revised in order to achieve an improved substitution of the incomes. A move in this direction is extremely important and necessary both for raising the confidence in the system and in the reform and in order to ensure the development of the latter. The significance of a similar step is also important in order to nullify the claims to Bulgaria in relation with the non-fulfilment, established by the respective bodies of the Council of Europe, of the commitments as regulated in art. 12 of the Revised European Social Chart. This is an issue for which no actions have been undertaken for more than four years now.

5.8. A parallel and not least important task set in the new formula was to improve the connection between the individual social insurance contribution and the amount of the pension received. Thus the following three elements have been included:

- continuity of the contribution period (each year of contribution period brings 1% of the average monthly insured income);
- the individual coefficient of the pensioner – the correlation between the individual insured income of the person and the average insured income for the country;
- the average monthly insured income from the previous year.

On the other hand, however, the so called transformation of the seniority of those working in hazard and risky occupational conditions as a result of which each year working under these conditions shall have a bonus of a certain coefficient. The “transformed” years of service thus obtained are set in the formula for determining the pension. Thus conditions were created for certain inequality between the insured persons working under different occupational conditions. Thus in spite of the formulation of the law that each year of contribution period will form 1% of the pension, finally something different comes out – one year contribution period for those working in hazard and risky conditions “brings” 1,67% of the average monthly insured income in the first category of labour, 1,27% – in the second category of labour, and there such categories where the contribution of the period of insurance for each year is 3%. It is true that this transformation of the length of service has its logical explanations and applications particularly in relation with the assessment of acquiring the right of a pension by those working under these occupational conditions. It is also true that in the context of the status quo of the factual situation as at the moment of the reform this transformation has practically provided guarantee for the rates achieved with the pensions received by such employees. However, it is also true that the use of the transformed length of service when determining the pension amount has created a certain overlapping of “privileges” as a result of which quite a large number of pensioners receive considerably higher pensions in comparison with their actual contribution to the system measured by the real time of their participation in it. The distortion of the balance thus obtained between the real /unified/ social insurance contribution of the persons and what the system gives them is a serious challenge facing the solidarity in the system and the normative regulations of the reform. Its solution however cannot be found in the direction of reducing the already acquired rights.

5.9. Following the implementation of the new legislation and the application of the planned yearly updating of the pensions a structure has been established with which not very well-grounded differences have emerged in the pension rates, granted before and after 1 January 2000. Moreover it is a question about the pensions of persons that have equal indicators reflecting the participation in the insurance and the individual contribution (i.e. provided equal values of the individual coefficient and the length of service). These differences were generated by the fact that after the year 2000 the pensions used to be updated on a yearly basis from 1 July (1 June) by a percent equal to the sum of the 25 percent increase of the insured income and 75 percent of the consumer’s prices index in the previous calendar year. At the same time the newly granted pensions have been calculated on the basis of the average monthly insured income for the previous year while since 1 January 2004 – on the basis of the average monthly insured income for the country for 12 calendar months prior to the one of the pension commitment – being a still more beneficial variant. Thus with every consecutive year the pension rates granted in the previous years keep “lagging behind” in comparison with those granted in the current year, since the updating is by a percentage

that is quite lower than the one of increasing the average monthly insured income. This resulted in a very severe “lagging behind” of the pensions granted before and in the year 2000, which revaluated (granted) in accordance with the then new pension formula at an average monthly insured income for 1999 of 180.05 BGN. For comparison – the pensions granted in January 2006 were calculated on the basis of an average monthly income for the country for 2005 – 331,62 BGN. According to the financial estimates of the National Social Security Institute the pensions granted in 2006 will be by 24,9 percent higher than the ones granted before and in 2000 and shall be indexed by the corresponding percentages from 1 June every year. For a comparison with the pensions granted in 2005 and indexed by average 5 percent from 1 January 2006, this difference will be 2,3 percent. Obviously the mechanism of the annual pension increases, no matter if called updating or rising, is an important and very effective instrument for managing the pension levels. It has insufficiently contributed so far for improving the quality of the pension protection and the reserves set therein should be best used.

5.10. The implementation of a bottom – protective and top – restricting threshold to the pension rates – has been also set in the new legislation and without particular obstructions it is used within the solidarity frames targeted at the regulated and gradual transition to involving still bigger social insurance periods respectively the insured incomes in them for the purposes of determining the pensions. According to some people the borders and restrictions specified possess an administrative flavour but in fact when a social system is the subject of discussion, such administrative and political instruments are not only admissible but they are recommendable. For the operation time of the pension system the so called ceiling (top limit) on the pensions has smoothly moved upwards and at present it is 455 BGN against 85 BGN of a minimum pension for contribution period and old age – or it exceeds the minimal pension by five times. The mechanism for its fixing creates definite concern since there is at hand a connection with the maximum insured income, which as a parameter has been introduced and used since the beginning of the reform. At the same time via this parameter the acting mechanism is used to determine the pension amount of persons whose contribution period in its predominant part is far back in time prior to the reform. Alongside with this, as stated in p. 5.8., it is often possible to reach or overtake this ceiling not due to the higher insured incomes but because of overlapping privileges within the very formula for calculating the pension. Therefore the logics of applying correctives to the pension formula by fixing the minimal or maximum pension rates or the sum of the pensions received by one person, is of paramount social significance. For the time being the maximum pension rate regardless of the claims to the methodology for its calculation is socially acceptable. But the mechanism for its determination indisputably needs specifying and objectivising in order to be “individualized” to the maximum possible extent.

5.11. A minimal rate of the survivor’s pension was introduced though not directly but in the course of the reform, which the law-maker have fixed to 90 percent of the old-age social pension. This norm, targeted at giving better guarantees, in practice created many occasions in which the link between the pension of the legator and the one/ones/ of his/her legatee/s/ was practically lost. By means of this norm the main regulation for the rates of the survivor’s pensions if one or more heirs has been suspended in a way and it is still present

in the law. An example is at hand for a compromise with the basic principles of the reform and most of all of the social insurance being justified by the ambition of looking for a better social protection. And such one is received indeed for single individuals and families. What about the moral effect in relation with the other insured and their trust and feeling for justice in the event of a similar benevolent overstepping of the formulations, isn't it what matters more? No one has yet run the risk with calculating it in order to compare the benefits and the damages. It can safely be said that it will be useful for the reform and the trust extended to it, respectively to the new legislation, to have the occasions when the sums paid to the heirs are exceeding the full pension of the legator reduced to exceptions.

5.12. Taking into consideration the procedures for generalized analyses and drawing up tendencies, it can be accepted that in Bulgaria after the reform the real value of the pensions is considerably raised. Apart from the above discussed instruments for their maintenance and rise, though unwritten in the rules of the reform but already developed into tradition, the one-time Christmas pension payments of equal or differentiated amounts and paid to every pension also have a definite contribution for improving the purchasing power of the pensions. Nevertheless, the sociological investigations show that the pensioners /both of longer time and of more recent time/ keep defining themselves and feeling as the most slighted part of the society. It is a wide-spread and mass opinion that they are paying the highest price of the transition to the market economy and the new social relations. This is particularly valid for the pensioners who receive pensions below the average one and for whom the pension received is the only source of incomes. Of course, the lonely elderly people with low pensions are in the gravest situation. With a view namely to this situation the rules of the reform have been modified once again this year by a political decision. The updating of the pensions was drawn from 1 January instead of 1 June and it was carried out by a differentiated percentage in accordance with the pension rates. And from the first of July the lowest pensions – up to 150 BGN were raised repeatedly and again in differentiated way. The minimal pension has raised from 72,45 to 85 BGN. And it has been declared that a new principle will be introduced for determining the rate of the minimal pension for contribution period and old-age /as a ratio from the minimal work salary/. It is lawful to ask the following question – isn't the different approach for updating the pensions in conflict with the established rules for justice and solidarity of the new pension system and further isn't the “packing” of the pension rates once again a way to equalization. The answers to these questions are not monosemantic in any case. However, permanent and good-quality improvement of the pension rates is hardly attainable by means of impulsive and incidental initiatives. This can be achieved only via planned, systematic and recourse-guaranteed actions.

5.13. The incentives, set in the elements of the formula for determination of the pensions, for improving the connection between the contribution of the pension respectively for encouraging the duration of the social insurance period, have not been particularly successful for the time being. Though by these parameters the more continuous participation could be stimulated and accordingly by decreasing the pressure of the “young” pensioners on the “Pensions” Fund the financial stability and the balance of the pension insurance could have been improved. However because of the comparatively low income in the country and as due to the insufficiently good knowledge of the social insurance, the incentives set cannot

work as they should. The later, deferred retirement is not appealing either due to the too liberal regime, regulated by the Constitutional Court, admitting to receive a pension and salary in full amounts. Both the “deferred” retirement and the forms for flexible and gradual retirement are serious and so far not explored reserves of the reform.

5.14. From point of view of “gender” neutrality provided other equal provisions the new pension system is more restrictive with respect to the women because of the more unfavourable characteristics which they have for the assessment of the pension – lower lawful age requirements, respectively also length of service as well as the lower by rule remunerations, which they receive in comparison to the men. The future development of the reform demands serious work on this issue.

### **B. Supplementary pension insurance**

5.15. Since the beginning of the reform the new second pillar of the Bulgarian pension system has been functioning successfully. The universal pension funds /UPF/ which are planned to secure a supplementary life pension for those born after 31 December 1959 and the professional pension funds /PPF/ – fixed-term pensions for those working under the first and second category of labour have already accumulated contribution payments designated for these purposes. The number of the insured involved in both kinds of the second pillar funds has already exceeded 2,2 million persons and the accrued assets from the contribution payments – 650 million BGN. In accordance with the lawful regulations the contribution payments are effected to individual lots of each insured where earnings are also accumulated from the profitability when investing these funds. Deductions from the contribution payments of the insured are collected in percentage, the maximum of which is fixed in the law with the idea of creating conditions for competition between the governing institutions. But in practice this maximum has turned out to be a standard in the prevailing part of the cases, which shows that this approach has not been effective enough to create conditions for competition, either to protect the interests of the insured persons in these funds. Probably it will not be useless after six years of experience to assess carefully the level of the deductions made on the contribution payments including the effectiveness of using them, moreover that all experts and analysers lay the stress on mastering the expenditures of the institutions that manage the capital schemes.

5.16. The receipts in the above-stated funds are formed from the contribution payments paid by the payers and the insured persons. The contribution payments in the universal funds are allocated between the latter while those ones made to the professional pension funds are paid only by the enterprises. Since the payments forwarded to the universal pension funds comprise a portion taken away from contribution payment to the “Pensions” Fund, then any modification in their amount will affect directly the behaviour of the deficit and the balance in the “Pensions” Fund of the State Social Insurance. Therefore the planning of these transfers will have obligatorily to “go through” an assessment of the long-term impact on the financial stability of the first pillar, which from the standpoint of the deficit has already got more serious problems than at the beginning of the reform. /440,8 mill. BGN have been diverted from the first pillar to the universal pension funds for the time of implementing the reform/.

5.17. It is still quite early to make sufficiently accurate prognoses about the rates of the second supplementary pension. There is still more to be done in relation with the regulatory requirements for the assessment of its rates, especially concerning the guarantee of gender equality /for equal capital – equal pension/. According to the estimates initially set by the reform the life supplementary pension from the second pillar should replace 15-18% of the income prior to retirement following a 20-year contribution participation in the capital pillar. With a view to that the contribution payments for it should be planned and estimated. There is time enough indeed till the moment when the payments of the pensions will start from the universal funds. But the role of these funds when regulating the substitution rate of the lost occupational income by a pension should not only be clear /and concrete/ from the very beginning but it should be well “rehearsed”. Somehow no special attention and interest has been taken these years in the rates of the fixed-term pensions for those working under the provisions of the second and first category of labour, which should be paid from the professional funds of the second pillar, and it is to happen in 3 years only. It appears that the danger of the fixed-term pension /particularly for a period of 36 months, as the case of the second category of labour is/, being considerably more beneficial than the basic one to be paid from the public solidarity pension fund after the expiry of the term, should not be neglected because this could be a conflict with unforeseeable consequences not only for the development of the pension reform.

5.18. As a whole the newly set up pension funds from the second pillar /according to data of the Financial Supervision Commission/ and in general the private sector of the pension insurance play a substantial role both in social aspect in relation with raising the social insurance compensation of the future pensioners and in economic aspect – as a factor for the development of the capital markets and the investments for the Bulgarian economy. Both capital pillars of the Bulgarian pension system /the supplementary compulsory and the supplementary voluntary pension insurance/ are of great importance for the development of the financial sector. It is considered that being the main institutional investors, the pension companies cooperate for the development of the capital markets and along the line of the demand they also favour the development of new alternative investment instruments. Even so the principal designation of the pension funds is to accumulate and increase the resources placed at their disposal so that they can guarantee the paying off of pensions to the insured and this is what must be always the main concern and main priority of the institutions and the public.

## ***6. The pension system and the European integration***

6.1. From point of view of the forthcoming integration of the country in to the European Union the new legislation of Bulgaria in the field of the pensions does not cause tension. The monitoring reports on the whole provide positive comments on this issue. However the problems demand special attention regarding the equal treatment of women and men in the pension insurance area.

6.2. The Bulgarian pension model, as well as the one in many states from the last enlargement, contains a significant structural, respectively terminological distinction from

the wide spread ones in the European Union (EU). What is called in Bulgaria a second pillar of the pension insurance does not coincide with the meaning implied in this notion in the EU. The main point in the difference is that the Bulgarian second pillar is not a result of collective bargaining or an initiative of the employer but it is compulsory and has been organized by the government with a law. Because of this reason the practice and the responsibilities for the Bulgarian state after the accession will be different from the point of view of ensuring the rights of the EU citizens when they exercise their right of free movement. Though at the very beginning this issue shall not be on the agenda in relation with the responsibilities of the country under Regulation 1408 of the EU, it will be necessary to pay a special attention to it in order to avoid possible ambiguities and conflicts.

6.3. As early as in its capacity of a candidate country Bulgaria has been included in the Open Method of Coordination (OMC) /rationalized/ in the pension area and has already prepared and presented the so called pension form (slip) which contains though a short version of a strategy for the future development of the pension system. Although this document was worked up with the participation of specialists and experts from many and different institutions and organizations, the biggest possible consensus was related to what else could be wanted till covering the recommendations of the European documents while preparing it /common objective 1 of the rationalized OMC/.

6.4. The founding formulation of the European guidelines for the development of the pension system is that it should pursue the trends of the labour market. The accelerated enforcement of non-typical so far forms of employment requires special revision of the existing pension model namely from this standpoint. Without tolerating one or other form of employment it should guarantee equal access to rights for all, should cooperate for the implementation of the flexicurity (flexibility combined with security) principles and should not impede the labour mobility either.

The acting social insurance legislation in Bulgaria in general does not create preconditions for different treatment of the employed in the existing non-typical forms of employment. When applying the principle of compulsories and generality, the first pillar as well as the second pillar shall involve all economically active persons where the provisions for an access to the social insurance system are universalized and they do not depend on the form of the occupational activity performed.

Social insurance coverage has been provided for the main non-typical forms of employment and namely employment consistent with the working time; matching the incomes; the duration of the service contract; the work place, working hours, organization of labour; the form of hiring; the interruptions in the occupational career; flexibility in relation with the working time – part-time working. The employees shall be obligatorily insured for all insured social risks in the event of part-time working provided they have been hired for more than five working days or 40 hours during one calendar month. Those hired for work with one or more employers for at least five working days or 40 hours during the calendar month shall be also socially insured but only against disability, old-age and death as well as against occupational accident and professional disease.

Since 2004 the amendments in the law have provided a possibility for a more precise recording of the contribution period for the part-time employed. The contribution period can

be calculated also in hours and in relation with the persons who have worked part-time it is recognized proportionally to the lawfully established working time. However, the issue of recognizing the contribution period in the event of permanent employment at part-time working but not more than 4 hours per day from the standpoint of the thus hired has not got a simple answer yet although the law-maker has provided a regulation thereof.

6.5. From the point of view of the form of hiring – self-employment, free professions, work without employment relationship and etc., the Bulgarian legislation provides for equality, at the same time considering the specifics of each form of hiring. In the context of encouraging the combination of different forms of employment and in relation with increasing the social security and in addition a rate has been introduced for a more beneficial recognition of the contribution period for the persons who are working simultaneously under:

- a service contract at full-time occupation and under a second service contract or an additional employment contract with daily working time not less than three hours;
- a service contract at full-time occupation and perform occupational activity as sole traders, owners or associates in commercial companies, free profession and/or craftsman's activity.

This norm does not enjoy wide popularity at the present, and in relation with improving the guarantees for the part-time hired persons it gives quite contradictory results. There is room for improved and new solutions within the scope of counting the requirements for equal treatment and considering the forthcoming direct responsibilities of the Bulgarian social insurance at international aspect.

6.6. One of the main requirements of Regulation 1408/71 refers to the portability of the pension entitlement and rights. No problems have been identified for the state pension system within the framework of the cost-covering pillar. Even when changing an employer or modifying the kind of the economic activity, the insured shall not suffer negative after-effects regarding their access to a pension because the contribution payments remain within one scheme. The portability of the pension rights under the supplementary compulsory social insurance in the universal pension funds does not create either expectation for problems confronting with the liabilities of Bulgaria /regardless of the employment form and the change of the employer, any economically efficient person born after 31 December 1959 that has been compulsorily insured under the first cost-covering pillar, shall be obligatorily insured under the second pillar as well/. Even so what has been stated in 1.6.2. on this issue stays valid.

6.7. The portability problem of the pension rights is related with the treatment of the professional schemes which Bulgaria has recently introduced in its legislation in the context of transposition of the European directives in the field of the free movement of people and capitals as well as in relation with the institutions managing the professional pension funds. The term professional fund corresponds here to the EU understanding about the second pillar in the pension insurance. In order the employees not to lose pension rights when exercising their fundamental right of free movement in the community, and also in the event of changing different employers within one and the same state at the European Community level, the efforts have been targeted at the creation of a legal mechanism which will eliminate the obstacles facing the portability of the pension rights under the professional

pension schemes. There is a suggestion for a directive of the European Parliament and the Council for improving the portability of the additional pension rights. This kind of pension schemes has not been practiced in our country and their emerging from today's point of view seems slightly probable.

6.8. The theme of equal standing between the sexes is in the focus for all European policies including the social protection and the pension insurance. Bulgaria has made considerable efforts to supply with occupational and social insurance legislation which will consider and encourage the implementation of the principles of equal standing and equal possibilities between women and men. The guiding Directives of the European Union have been transpositioned; the main Conventions of the International Labour Organization in the context of the gender equality have been also ratified. Thanks to that on the eve of the European full-membership of the country, the Bulgarian pension legislation is "gender neutral" at its basis, i.e. the gender of the person does not influence when determining the scope of the pension schemes, the access to a pension entitlement and rights, the rate of the contribution payments as well as when calculating the amount and the commitment of the pension payments. This refers to all pension schemes in the three pillars of the Bulgarian pension system, including the professional pension schemes in the voluntary third pillar introduced in the year 2006. However, the fundamental difference in the retirement age has been kept in the lawfully established first (public solidarity) pillar – the minimal retirement age for the men is – 63 years old, while for the women it is 60, which because of the gradual increase will be reached in 2009. These distinctions have been also transferred in the lawfully established second (capital) and voluntary third (capital) pillar since the entitlement to a pension from them is related with the retirement age under the basic first pillar. The adjustment of the gender differences in the retirement age is one of the most crucial challenges for the future development of the reform in the pension system.

6.9. The consequences from the lack of gender neutrality in relation with the pension age for the development of the pension system have an extremely serious and many-sided importance. In the first place, this leads to domination of the women in the total number of pensioners. In the second place, it provides incentives and sometimes forces the women to retire from an active occupation earlier than the men. In the third place, the low retirement age determines the women to retire also with lower duration of the contribution periods which objectively brings about low amounts of their pension compensations. While carrying out the change, the insufficient contribution period and the social insurance under incomes, incomparable from today's standpoint as regulated in the former legislation as well as the inflation waves, have stimulated the expansion of the inequalities in the pension rates. The measures realized in the field of the guaranteed minimal payments for the pensions' update, for receiving the so called widow's benefits, as well as in certain cases of receiving more than one pension, undoubtedly have contributed to the improvement of the pension adequacy including for the women. However the problem has not been solved. In the context of the gender differences in the duration of the contribution period stress should be laid on limiting the risk of reproduction of the present differences in the future. The contribution period is a basic element in the pension formula and the presence of big differences in its duration will inevitably affect the pension levels of the women and those of the men. The substitution

coefficient and the pension levels with the women are much lower than the ones for the men, whereas the differences grow in direct ratio to the rise of the age. Serious differences are observed in the pension rates between the men and the women and they are one of the factors determining the higher risk of poverty among the women over 65 years old. The women are again the most vulnerable ones among the old people living in solitude who constitute the group living in the highest risk of poverty.

Mastering the reproduction of these differences should be an accent in the pension policy. Grounds for threats of keeping them up are not missing. As of 31 December 2005 the average rate of the newly granted pensions for contribution period and old age for the men exceeded by over 34 percent those ones granted to the retired women. The difference is not explained solely with the shorter duration of the contribution period of the women but it is much more due to the big differences in the insured income. This is proved by the data about the average individual coefficient of the persons with the newly granted pensions. As of 31 December 2005 the men who retired at the third category of labour with a newly granted pension for contribution period and old age in the current year, had an individual coefficient of 1.508 compared to 1.159 for the women at the same category of labour and entitled to the same pension. This gives a difference of over 30 percent and means that the average incomes on the basis of which they have paid their social insurance exceeded by about 51 percent the average insured income for the country for the period used to determine the pension amount. These data should not be related with the social insurance legislation only. They objectively demand to make a serious analysis on the labour payment level in the separate industries, the adherence to the labour legislation and particularly the principle “for equal and equal standing labour – equal salary” – a principle the adherence of which is even an object of court proceedings in the EU.

6.10. The role of the policies and the measures of the labour market for the situation and the development of the pension system in the light of the pan-European objectives and values receives still bigger significance and commitment looking forward to the EU membership of the country. From this point of view the connection **between the strategy and the policies in the area of the pensions and the National Employment Operation Plans should get deeper, more operational and precise.**

## ***7. Europe for the reforms in the pension area***

7.1. As early as 1999, following an Appeal of the European Commission, called **Concerted strategy for modernization of the social protection**, a wide consensus was established in the European Union that the reforms of the social protection systems, which the member states were carrying out, should meet four high objectives:

- Labour should be more privilege providing and offering safe income;
- To guarantee safe pensions and viable pension regimes;
- To increase the social integration /social involvement/;
- To guarantee high and long-lasting level of the health protection.

7.2. The European Council in Lisbon has formulated **an overall strategy for sustainable development with more and better jobs and becoming more socially close**. The Lisbon

policies in the field of economy, labour market and the social area necessitate the provision of more manpower in the conditions of the aging and diminishing population. The main challenges facing the pension systems come from their connection with the labour markets. The Lisbon conclusions have pointed out that on the basis of a sustainable economic development of 3% GDP the member states should achieve a sharp employment increase till the year 2010 with a particular attention to the employment for women. In the conditions of the demographic challenges the employment rate will play in the future a basic role for ensuring the stability of the pension systems in all the countries. The reform in the pension systems on their part will also play a key role for providing better employment initiatives.

7.3. The European Council in Barcelona has once again launched an appeal that "the reform in the pension systems should be accelerated in order to ensure simultaneously their stability and the achievement of their social targets". The member states were asked to present the first reports for their national strategies till September 2002. The presented reports have detailed how and by what measures the member states will achieve the eleven common goals set. With a view to achieve financial stability of the pension systems the member states have oriented to **a three-stage strategy for the settlement of the budget problems related with the aging of the population**, established by the Council in Stockholm and later included in the 2002 Frame Guidelines of the Economic Policy.

The three stages are: scaling up the employment rate; reducing the levels of the public obligations and placing the pension systems on solid financial bases. The measures undertaken by the member states include: restricting the inflow into the early retirement scheme; increasing the incentives for prolongation of the occupational life; raising the future budget differences by reducing the public debt and setting up public pension reserve funds. In accordance with the principle for the subsidiarity, the responsibility for the design and management of the pension systems remains for the member states.

7.4. The conclusions of the European Council in Barcelona in March 2001 laid the foundations of an Open Method of Coordination /OMC/ in the pension area. This process was finally started by the European Council in Laaken on the basis of **11 common objectives under three titles: preserving the capacity of the systems to meet their social targets; maintaining their financial stability, and meeting the changing social needs**. In conformity with the principle of subsidiarity the Open Method of Coordination includes an agreement on the frameworks of the common goals, the transformation of these goals into national political strategies and as a part of the process of the peer reviews, recurrent monitoring on the progress on the basis of generally agreed and definite indicators. The OMC contribution is to be found in the integration of the economic and social standards and in the provision of a frame for integrated reporting on all issues for securing the future pensions; frame for working up the common understanding of the national strategies in this relation; detailed information and analysis of the national pension strategies, which come within the formulation for political recommendations from the Economic Policy Frame Guidelines and participate in the preparation of the other processes.

7.5. Within the process established at the Summit in Lisbon 11 common objectives have been worked up in the pension area united under **three main principles**:

### **Adequacy of the pensions**

The member states have to keep the capacity of the pension systems for achieving their social goals. In this direction taking into consideration their national specifics they have to:

1. Secure the elderly people not to be placed in risk of poverty and to be able to lead a well-deserved life; to be able to take advantage of the economic welfare of their country and respectively get actively involved in the public, social and cultural life;
  2. Ensure an access of all individuals to the adequate pension schemes, public or private, which will allow them to receive pensions that will let them keep their living standard to a reasonable extent after retirement;
- and
3. Encourage the solidarity within and between the generations.

### **Financial stability of the pension systems**

The member states have to apply a versatile strategy for placing the pension systems on a solid financial basis including an adequate combination of policies for:

4. Achieving a high level of employment through, where necessary, all-embracing reforms of the labour market, as envisaged in the European Employment Policy and in a manner corresponding to the Economic Policy Frame Guidelines.
  5. Ensuring that alongside with the labour market and the economic policies, all respective sectors for social protection, the pension systems in particular, will offer effective incentives for the involvement of the elderly working people; that the working people will not be encouraged to take advantage of the opportunity for early retirement and that they will not be punished for staying at the labour market after becoming of the standard retirement age; that the pension systems will facilitate the possibility for gradual retirement.
  6. Reforming the pension systems in an adequate way by taking into consideration the common goal of maintaining the stability of the public finances. At the same time the stability of the pension systems has to be accompanied by stable fiscal policies involving if necessary a reduction of the debt. The strategies adopted for the achievement of this goal should also include the establishment of specialized pension reserve funds.
  7. Ensuring that the granted pensions and the reforms will maintain a just balance between the active people and the pensioners where the first ones shall not be overloaded and sufficient pension amounts shall be kept for the latter ones.
- and
8. The private and the public pension schemes to provide pensions of due efficiency, amount, portability and safety by attaining and applying suitable regulations and stable management.

### **Updating the pension systems in response to the changing needs of the economy, the society and the individuals**

9. Ensuring that the pension systems are comparable with the requirements for flexibility and security of the labour market; that without harming the concordance between the tax systems of the member states, the mobility of the labour market within the member states and beyond the border as well as the non-standard forms of employment, that they will not affect the rights of the people to get a pension and that the pension systems will not discourage the self-employment.

10. Revising the pension regulations in relation with ensuring the principle of equal treatment of the women and the men taking into consideration the commitments in accordance with the EU legislation. and

11. Making the pension systems more transparent and adaptable to the changing circumstances so that the citizens will continue to trust them. Preparing reliable and easy to understand information about the long-term perspectives of the pension systems, first of all in relation with the probable development of the levels of the incomes and the contribution payments. Supporting and encouraging the widest possible consensus on the pension policies and reforms. Improving the methodological basis for an efficient monitoring on the pension policies and reforms.

7.6. In an Appeal of the European Commission of December 2005 “To work together, to work better: **“New frame for open coordination of the social protection policies and for social integration in the European Union”** has confirmed the engagement of the EU to modernize its social model on the basis of general principles such as the social justice and the active involvement of all citizens in the economic and social life. The Commission has reconfirmed the necessity that Europe is to modernize its systems for social protection in order to ensure their viability in the future as well as that the policies pursued in Europe have to continue enhancing the social cohesion, the equality of chances and solidarity between the generations and at the same time responding better to the economic and social changes thus favouring the employment increase. In the same Appeal the Commission has outlined proposals aimed at the rationalization of the Open Method of Coordination by uniting the actions in the pension area and the social integration. An object of the Appeal was also the adoption of the new common objectives for the three trends /pensions, social inclusion, health and long-term cares/ for the implementation of the new procedure. Common objectives have been suggested for the rationalized OMC, which have to pierce through the strategies and actions in all spheres – an object of the method, as well as objectives for the different areas of impact.

#### **OMC common objectives for social protection and social integration:**

1. To enhance the social cohesion and the equality of chances for all through the social protection systems and through policies for social involvement – adequate, accessible, financially viable, adaptive and effective ones;

2. To act in close conformity with the Lisbon objectives targeted at the intensification of the economic growth and the quantitative and qualitative improvement of the employment as well as in concordance with the EU strategy for stable development;
3. To improve the management, transparency and participation of the parties concerned in the conception, execution and surveillance of the policy.

**The objectives in the area of the pensions** have been stated by the EC under a title familiar and well-established in this area:

To secure adequate and viable pensions

1. In the spirit of solidarity and justice between the generations and within each one to guarantee everybody an adequate income in retirement and an access to a pension, admitting to keep a reasonable and decent living standard after retirement;
2. In the context of a healthy management of the public finances to ensure the financial viability of the public and private pension regimes supporting the prolongation of the professional life and the active growing old thus favouring the financial accessibility and providing for the security of the capital schemes and the private pension regimes;
3. To see to the pension regimes to be transparent, well adapted to the needs and aspirations of the women and the men and to the requirements of the modern societies, the demographic aging and the structural changes; to look after the people to obtain the information they need in order to get ready and prepare their own retirement and the reforms to be performed on the basis of the widest possible consensus.

**Appendix No 2****ACTUARIAL ANALYSIS OF THE PENSION SYSTEM**

The actuarial estimates made in 1998 and the beginning of 1999 indicated a downfall of the former pension system in Bulgaria because of the enormous amount of rights accrued and the lack of financial coverage for them. In order to prevent such failure either the pension contribution payments should have been increased up to 60% or the pensions should have been decreased to 20% of the income received prior to retirement. The objective of the pension reform was to prevent this failure and create circumstances towards financial stability of the State Social Insurance (SSI) funds in long-term aspect.

The decrease of the pension fund subsidy from the state budget was one of the most important objectives of the pension reform. That /as of the long-term prognosis' initial scenario for the period 2000-2050/ would have been achieved in 6-7 years after starting the reform. The state subsidies and transfers for the non-contributory pensions had played an important role during that time. Moreover the decrease of the budget subsidies should not have been as an end in itself.

The actuarial team's prognosis of the National Social Security Institute (NSSI) about the average and the long term status of the state public insurance funds have been used both for developing the new social security legislation and upon each essential modification in it in order to evaluate the financial effect of the change. The initial prognosis made at the end of 1999 and the beginning of the year 2000 and the latest ones made in December 2005 by applying the actuarial model of the National Social Security Institute demonstrated serious margins within the macroeconomic parameters and those parameters related to basic indicators for the receipts and expenses in the „Pensions” Fund of SSI /rate of the contribution payment, number of new pensioners resulting from **additional privileges in the legislation, changes in the date of updating the pensions** – article 100 of the Social Insurance Code, and etc./

The 2005 prognosis has been developed by the updated version of the model which reports better on the changes in the State Social Insurance (SSI) after the introduction of the second pillar of the pension insurance and the more rapid increase of the contribution payment – up to 5% in 2007 for the universal pension funds. The legal base – Social Insurance Code, which has been changed many times in the period 2000-2005, serves as grounds for both forecasts. The prognosis from the end of the year 1999 has been based on the report information about the pension system obtained upon the social insurance legislation valid till the year 2000 while the one from the year 2005 – as of the report information from the year 2004 – 5 years following the reform. The short-term compensations are not treated in the analysis. **The 1999/2000 prognosis pointed out a deficit for the SSI funds up to the year 2006, and the one from the year 2005 recorded a deficit for the SSI funds up to the year 2010.**

The comparison is made in relation to the admissions (macroeconomic, demographic, admissions related to the SSI) and their effect on the status of the SSI funds.

**Macroeconomic admissions in both prognoses are as follows:**

Inflation: Prognosis from the end of 1999 and the beginning of 2000 is of better optimistic admissions about inflation in comparison to the growth recorded up to 2004 and the prognosis from 2005.

Unemployment: Prognosis from 1999/2000 foresees a lower level of unemployment in comparison with the reported period till 2002 but the 2003 one is a little bit higher.

Labour efficiency is a productive value of the gross domestic product (GDP) growth and the number of the people employed in economy: The 1999/2000 model generated a lower GDP growth compared to the one reported up to 2004 and higher employment (lower unemployment, higher coefficient of manpower participation and higher number of the active population). If inflation data, unemployment level and labour efficiency in the 1999/2000 prognosis are substituted by the reported data up to 2004 including, the prognosis for the year 2005 demonstrates a deficit higher **by 174 million BGN as compared to the initial one.**

**Demographic admissions:**

Population: Prognoses make use of reported data about the population by gender and single ages as incoming information provided by the National Statistical Institute. The 1999/2000 prognosis utilized the 1992 census data while the one of 2005 – the 2001 census data, the latter being more accurate and the total number of the population is by 150 thousand persons less.

Admissions for the coefficients of fertility, death and emigration in the **2000 prognosis** are more optimistic in comparison with the real data and the new prognosis of 2005. If demographic admissions data in the 1999/2000 prognosis are substituted by the report data up to 2004, the SSI funds deficit shall be increased **by 65 million BGN more resulting from the worsen demographic indicators.**

**Admissions related to the state social insurance:**

Indexation of pensions: Pensions are indexed by 20% of the inflation and 80% of the insured income real growth /as was set for the year 2000/ in the 1999-2000 prognosis while the prognosis of 2005 is coordinated with the new regulation in article 100 of the Social Insurance Code (SIC). If data about the pension growth and insured income in the 1999/2000 prognosis are substituted by the reported levels up to 2004, then the SSI funds deficit shall be increased by **755 million BGN** more in the 2005 prognosis and the term is prolonged by two years (2008).

Maximum pension: In the 1999/2000 prognosis, the maximum pension rate is equal to four times the social pension rate. Since 2004 it is defined as a percentage of the insured income. At the beginning of 2004 the size of the maximum pension exceeded eight times the social pension rate. The deficit of the SSI funds is moved one year further (2009) and is increased by **159 million BGN** more following the execution of that change in the prognosis too.

Social insurance contribution to supplementary compulsory pension insurance: The 1999/2000 prognosis plans that gradually by the year 2009 5 % points shall be taken from the contribution payment and forwarded to the „Pensions” Fund for supplementary compulsory

pension insurance of the persons born after 1959. Later on a decision was taken towards a sharper increase of the 2<sup>nd</sup> pillar pension contribution – up to 2007 which increased the „Pensions” Fund deficit by **235 million BGN** more.

Other factors having seriously affected the „Pensions” Fund deficit during that period are related to the:

Total number of pensioners and pensions. Foresights made in 1999/2000 prognosis about the total number of pensioners and pensions in 2005 differ from the reported number – about the pensioners by about 90 000 more and by around 199 000 pensions more. That is due to:

- sharp increase of the disability pensions number resulting from general disease. The number of the personal initial disability pensions almost doubled and expenses reported increased by **250 million BGN** during the period 2000-2004.
- increased number of retiring army officers /because of the current army reform/ and the infringed balance between the social insurance contributions and the considerations (compensations) for these persons.
- re-calculation of pensions granted prior to 2000 by new sizes because of the change in the type of the pension (from contribution period and age pensions into disability pensions for general disease). Instead of a decrease in the number of pensioners envisaged by the reform and reflected in the 1999/2000 forecast, in fact the number of pensioners increased thanks to those granted on disability for general disease and the pensions.

The so-called “base” has been modifying by changing the type of the pensions, which has brought to a considerable increase of the pension costs. The deficit has been prolonged to the year 2011 and increased by further **854 million BGN**.

After the enactment of the Compulsory Social Insurance Code in the year 2000, it has become possible for the certified persons to get the so-called second social pensions for disability, their number reaching 423 993 in 2005 for the expired period.

**By decreasing the social insurance contribution to the „Pensions” Fund by six percentage points from 1 January 2006,** the financial status of the state social insurance funds in long-term aspect has been further essentially modified in comparison to the results noted before and the actuarial prognosis show that the **„Pensions” Fund shall be in deficit for the complete period /2006-2050/.**

The update of the pensions for the year 2006 was made as of the first of January of the calendar year (modification of article 100 of the Social Insurance Code) in order to increase the incomes of the pensioners.

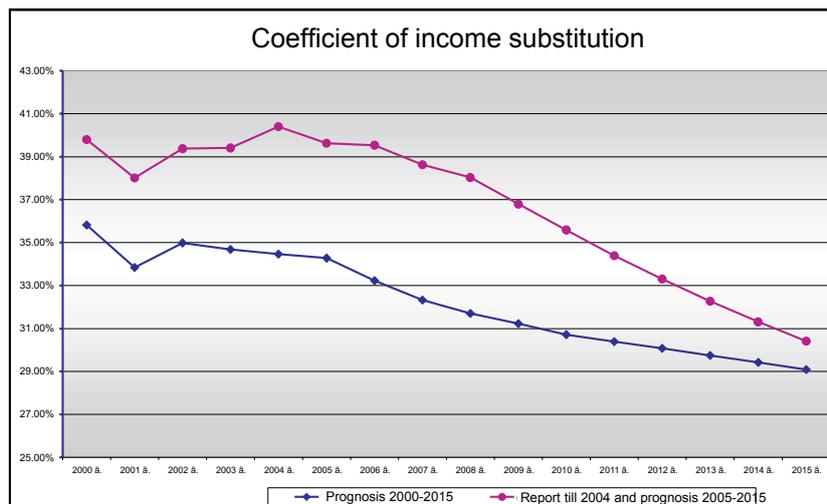
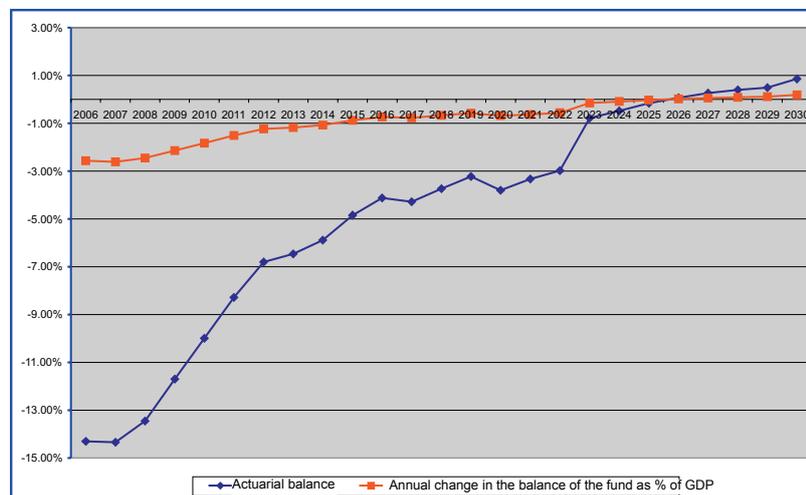
**The new assumptions** set in the prognosis are:

Macroeconomic indications of the 2006 budget and the three year forecasts till the year 2008.

Social-insurance – the complete regulatory basis according to the Social Insurance Code by a change in updating the pensions and decrease of the social insurance contribution to the „Pensions” Fund, according to the proposals.

Modified admissions for the year 2006 resulting from the decrease of the contribution payment to the „Pensions” Fund – increase of the average insured income (nominally by around 8 percent in 2006 in comparison to 2005); decrease of the unemployment level (by around 1,5 % points) and an increase in the coefficient of the manpower participation (by about 0,3% points). We are expecting the positive effect of the contribution payment decrease to appear somewhat later and have an effect in the coming years.

**The analysis of the SSI funds status for the period 2006-2050 specifies that the financial effect of these legislative changes is a deficit till the year 2050, in other words the SSI “Pensions” Fund cannot be self-financed.** In order to balance the budget of the SSI funds, a financial support for the deficit will be continuously necessary. The graphic below illustrates these results:



Basic parameters affecting the financial stability of the „Pensions” Fund, range of **changes related to the contribution rates** in the period 2000-2006:

- **2001** – reduction of contribution payment to the „Pensions” Fund by 3 points /bringing about a decrease of receipts by **225,2 million BGN**/.
- **2002** – reduction of contribution payment to the „Pensions” by 2 points about the persons born after 31.12.1059 /decrease by **70,1 million BGN**/.
- **2002** – dropping off the contribution payment to the “Pensions” Fund about persons entitled to a financial compensation from the “Unemployment” Fund /decrease by **58,2 million BGN**/.
- **2004** – reduction of the contribution payment to the „Pensions” Fund by 1 point more for the persons born after 31.12.1959 /or the contribution to the second pillar – the universal insurance funds – becomes 3%, which leads to a decrease of the receipts from the contribution payments to the „Pensions” Fund by **46,9 million BNG** more/.
- **2004** – dropping off the contribution payment to the “Pensions” Fund at the expense of the employers on compensations for temporary disability and pregnancy and birth giving – /decrease of receipts by **36,7 million BGN**/.
- **2004** – assuming the second and third day of compensation because of general sickness, pregnancy and birth by the National Social Security Institute (NSSI) by which the costs for these kinds of compensations scale up /additionally by **34,2 million BGN**/.
- **2005** – reduction of the contribution payment to the “Unemployment” Fund from 4 % to 3,5 % because of introducing a contribution payment to the “Guaranteed receivables of the workers and employees” fund – decrease of receipts by **34,6 million BGN**.
- **2005** – dropping off the contribution payment to the „Pensions” Fund at the expense of the employers on compensation for temporary disability and pregnancy and giving birth –/decrease of receipts by **39,8 million BGN**/.
- **2006** – reduction of the contribution payment to the „Pensions” Fund by six percentage points resulting in decrease of the receipts by around **620-630 million BGN**.

The effects stated are calculated on year base only and relate solely to the financial year they are enforced in. However the long term effect of the listed legislative changes is multiplied many a time, accumulating from one year to the other and exercising a lasting and long impact on the financial stability of the SSI funds and on the “Pensions” Fund in particular.

### **Problems of the population ageing**

The gradual increase of the minimum retirement age and the decrease of the number of those privileged with entitlement to an early retirement is a basic measure for coping with the unfavourable demographic changes. Outside the pension system, the government is pursuing a policy of encouraging the employment with the purpose of raising the number of the contributors and decreasing the number of those persons dependent on transfer payments. A gradual drop down of the dependency coefficient is expected during the coming years while around the year 2015 around 87 pensioners shall correspond to 100 socially insured individuals.

That problem is also related to the labour market as well as to policies for encouraging the people in pre-pension and pension age to continue working.

The Bulgarian pension reform creates some pressure on the labour market. The increase of the retirement age and the possibility of both working and receiving a pension bring about an increase of the labour force offered. Nevertheless a special research shows that there is no direct conflict between the youth and pensioners because of the fact that in most of the cases they compete on different labour markets.

Actuarial forecasts developed by the National Social Security Institute (NSSI) in May 2006 in relation with the latest demographic prognoses of the population ageing and the foresights for the situation of the economy show the following tendencies:

Population ageing is related not only to the increase of the elderly population but also to a decrease in the number of the population in the youngest age. According to the National Statistical Institute (NSI) data, the average age of the population is increasing – being 37,5 years in 1990, raising to 38,9 years in 1995 and reaching 39,6 years in 1999. The average age of the population for the country in general was already 41,1 years in 2005.

According to data reported for the year 2004 by the National Statistic Institute, the average life expectancy from zero age is around 68,68 years for the men and 75,59 for the women, which is less than in most of the European countries. The average life expectancy about the forthcoming duration of life about the men at the age of 63 is 13,91 years and about the 58 years old women is 21,31 years.

According to the thus made admissions, in 2030 the life expectancy from zero age is 71,59 for the men and 78,17 for the women, in the year 2050 – 73,66 for the men and 79,01 for the women. The average life expectancy about the forthcoming duration of life in 2030 about the men at the age of 65 is 14,69 years and about the 65 years old women is 17,54 years, while in 2050 – it is 19,38 for the men and 22,99 for the women.

The NSSI long term actuarial model covers the foresights about the actuarial situation of the SSI funds for a period from the year 2006 to the year 2050 at a consolidated basis while the surplus in any of the funds is used for covering the deficit of the other funds, if there is any. The actuarial calculations are made on the basis of reported information and admissions about the main macroeconomic indicators, the demographic indicators for the population and the reported data from the statistics of the National Social Security Institute and the regulatory framework according to the Social Insurance Code. The long term actuarial situation of the SSI funds is measured by the “actuarial balance” for a long term period – from the year 2006 to the year 2050.

The actuarial balance stays negative /-5,86%/ for the whole investigated period which shows that the expenditures under the SSI funds continuously exceed the receipts.

Two of the most important indications defining the financial stability of the basic compulsory pension insurance, are the dependency coefficient /the pensioners' number or number of pensioners to 100 insured individuals/ and the coefficient of the income substitution /the correlation of the average pension towards the average insured income/.

These coefficients are clear manifestation of the global demographic trends, which do not pass us over and which are closely related to three demographic indicators, characterizing the present situation:

- low birth rate /fertility coefficient – 1,3 compared to – 2,1 for normal reproduction of the generations/;

- improvement of the death coefficient expressed in an increase of average life expectancy;
- clearly-expressed external migration.

As a result the age dependency coefficient of the population /correlation of the population in over-employability age (65 and more years) to the population in employability age (from 18 to 64 years old) is changing from 26,3% in 2005 to 47,5% in 2050.

The dependency coefficient dropped down from 88,01% in 2006 to 87,7% in 2011 as a result from introducing stricter requirements for acquiring entitlement to a pension and an increased number of the insured individuals. The level is retained under 90% by the year 2022 and after that it goes up by nearly 0,5 points each year because of an increase of the life expectancy and maintaining a birth rate of 1,7 children per a woman, which shall bring about to an increase in the dependence coefficient to 111% in the year 2050. Even if all employed persons are insured, this coefficient would become better by around 10%.

The net coefficient of income substitution at present is around 50% keeping the same level by the year 2010 and then it shall start slowly to drop down becoming 34,4% in 2050 – the end of the investigated period. The pensions provided by the compulsory pension insurance in Bulgaria are not taxable therefore it is proper to compare them with the net income prior to retirement.

The net coefficient of income substitution for a long term period goes down more notably because of the transition to using the insured income for the whole contribution period in the pension formula, as well as from decrease of the pension rate for persons who are going to get additional pension from the universal funds of the second pillar. By adding the substitution income coefficients from the first and second pillars, the picture is quite different – in the year 2050 it is already 45%.

It has to be taken into account that one of the main objectives of the actuarial calculations is to inform the politicians and the broad public about the expenditures under the separate programmes of the state social insurance. The expenses related to the basic state social insurance programmes are prognosticated far ahead so that an indication could be given about their general appearance and the final level of the programme costs from the point of view of the contribution payment rates needed for their financing, but there could always be slight deviations from the forecasted parameters because of non-reported or occasional factors influencing the actuarial balance of the funds.