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The hectic restart of the long-awaited Bulgarian pension reform

Boyan Zahariev
September 2015

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Directorate-General for Employment, Social Affairs and Inclusion
Directorate D — Europe 2020: Social Policies
Unit D.3 — Social Protection and Activation Systems

Contact: Valdis ZAGORSKIS

E-mail: *Valdis.ZAGORSKIS@ec.europa.eu*

European Commission
B-1049 Brussels

EUROPEAN COMMISSION

EUROPEAN SOCIAL POLICY NETWORK (ESPN)

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Social Policies in Brief
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Theme(s):	*Pensions*
Title:	**The hectic restart of the long-awaited Bulgarian pension reform**
Category:	*Adopted legislation*
Abstract:	In 2015, major legislative changes concerning the Bulgarian pension system were discussed and finally enacted with the aim to make the pension funds sustainable on the long run. Bulgaria has a three-pillar pension system with a mandatory state pillar, a mandatory funded pillar and a voluntary third pillar. Some of the adopted measures were very controversial and widely criticised.
Description:	Bulgaria is facing an ageing population and a shrinking labour force. In the last years, it gradually became clear that the pension system could not be sustainable, and reforms would be needed, including a combination of an increase in the pensionable age and a rise in social security contributions. These measures were unpopular and the pension reform was stopped and restarted several times with a different set of proposals. On 28 July 2015, the Bulgarian National Assembly adopted important changes to the Social Security Code. The first change was a 2 percentage point increase in social security contributions – 1 point from the beginning of 2017 and 1 point from the beginning of 2018. Such a mild increase was recommended in a report by the World Bank (Doemland et al: 2013). A more profound – and unpopular – pension reform in Bulgaria was however unavoidable. The onslaught of the global economic crisis which affected the labour market and the payment of social security contributions indeed made reforms more urgent and transferring difficult budgetary constraints to later governments was not an option. This led to several episodes of starting, halting and restarting the reform, each time with a different set of proposals and a different timeline. The second, far more important change in the amended Social Security Code concerns the increase in the pensionable age. In 2015, the pensionable age for men in Bulgaria is 63 years and 10 months; for women it is 60 years and 10 months. From 2017, it will increase gradually for both men and women to finally reach the target of 65 years by 2029 for men and by 2037 for women. For men, pensionable age will increase by 2 months in 2017 and by 1 month every subsequent year. For women, it will increase at a faster pace - by 2 months each year from 2017 until 2029 and by 3 months each year from 2030 to 2037. The required contribution period (currently 38 years and 2 months for men and 35 years and 2 months for women) will also increase gradually for both genders; by 2 months each year staring from 2017 until it reaches 37 years for women and 40 years for men. Finally, a third important change, the most controversial one, is the possibility of multiple shifts by the socially insured between the first and second pillars of the pension system. Those who are insured in a private pension fund can choose to transfer their funds from that fund to the state pension fund and continue to pay the sum of the two contributions into the state pension fund. It is also possible to shift funds back from the state pension fund to a universal pension fund. This operation can be

	performed every year in both directions, up to five years before the pensionable age. In a mission report from March 2015, when the changes were still under discussion, the International Monetary Fund called the optionality in the second pillar of the pension system “a fundamental change” and the opportunity for multiple shifts was deemed “unorthodox”. PensionsEurope, the European federation that represents national associations of pension funds produced much more critical statements about the reform undertaken in Bulgaria.
Outlook & Commentary:	For many years before the current reform, the state pension fund was becoming increasingly dependent on additional transfers from the state budget. Reductions in social security contributions, which were made with the intention of stimulating the labour market, negatively affected the long-term sustainability of the state pension system. The pension reform had therefore become unavoidable. While increases in the pensionable age and social security contributions were expected, the opportunity to allow multiple shifts between the funded and PAYG pillars of the pension system was something new, and came as a surprise to many observers. It is not easy to find a parallel to this idea in other countries: its impact is therefore very difficult to predict but raises some key questions. First of all, it is not possible to assess the potential take up of the proposed measure. *By whom and how often will shifts between the two systems be made?* One possibility is that most of the people will move away from the second pillar of the system once and for all. Bulgarians do not place much trust in private pension funds. The potential impact on the adequacy of pensions in the future is also questionable. An ageing society such as Bulgarian society, with a shrinking labour force, will inevitably experience difficulties in providing adequate pensions in the future without a well-performing funded pillar in the pension system. The overall public sentiment as to the opportunity for shifting between the pillars of the pension system was positive, because technically the government just offered additional opportunities which anyone was free to use or not to use. But if the funded pillar of the pension system is shaken by the outflow of contributors, this will also inevitably affect those who chose to stay with it. What can be recommended in the immediate future is to strengthen the work of the financial regulatory institutions in Bulgaria, and make the private pension fund system more transparent. This will raise credibility and put the funded pillar of the pension system on a stronger foundation. The reform will only be reversed if some of the potential risks associated with the reform materialise into easily-perceivable threats or actual losses. It is very likely that the increase in the pensionable age will be easily offset by further gains in life expectancy, which will require a further increase in the pensionable age beyond 65. The question of a further increase in social security contributions is therefore likely to come back on the agenda rather sooner than later. Other difficult elements of the pension reform such as invalidity pensions will have to be revisited in the near future. This should be done only after improving the scope and adequacy of social safety nets in order to prevent further increase of poverty rates, which are already among the highest in the EU.
Further reading:	Law for the Amendment of the Social Security Code, State Gazette (61/11.08.2015), 2015.

	The World Bank "Pension Reform Options for Bulgaria," World Bank Course on Pension Reform (Washington D.C.), 2014. Doemeland, D. et al. Mitigating the Economic Impact of an Ageing Population: Options for Bulgaria, The World Bank, 2013. Manov, B. Defitsiti v darzhavnata pensionna sistema i Srebarniya fond (Deficits in the state pension system and the Silver Fund) Икономическа мисъл (Economic Thought) (3), 2013, pp. 3-20. Bulgaria: Concluding Statement of the 2015 Article IV Mission, March 13, 2015, International Monetary Fund, 2015.
Author:	Boyan Zahariev boyan@hotline-bg.com