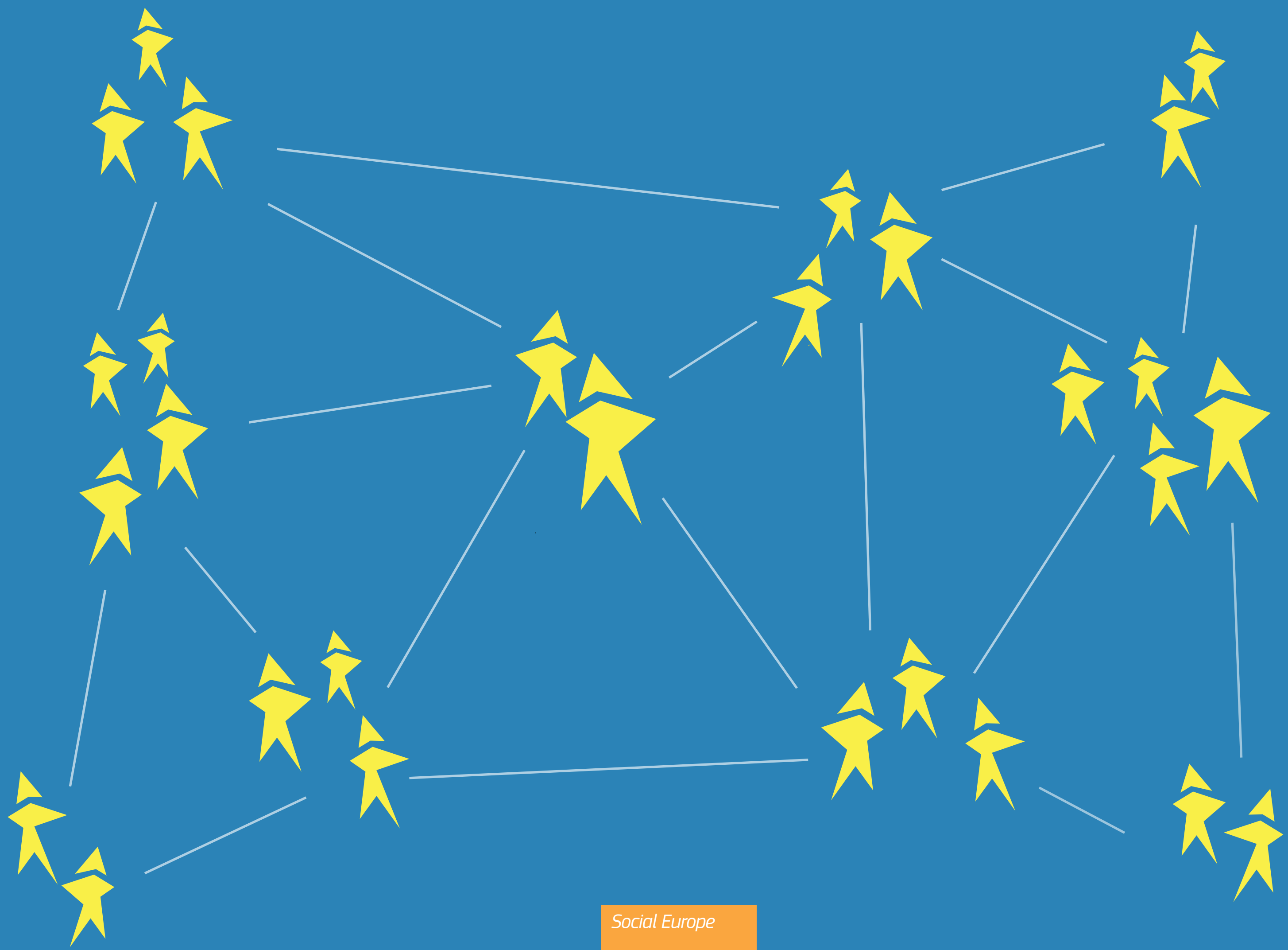
European Commission

EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Financing social protection

Bulgaria

Boyan Zahariev



Social Europe

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ESPN Thematic Report on Financing social protection

Bulgaria

2019

Boyan Zahariev

Directorate-General for Employment, Social Affairs and Inclusion

2019

The European Social Policy Network (ESPN) was established in July 2014 on the initiative of the European Commission to provide high-quality and timely independent information, advice, analysis and expertise on social policy issues in the European Union and neighbouring countries.

The ESPN brings together into a single network the work that used to be carried out by the European Network of Independent Experts on Social Inclusion, the Network for the Analytical Support on the Socio-Economic Impact of Social Protection Reforms (ASISP) and the MISSOC (Mutual Information Systems on Social Protection) secretariat.

The ESPN is managed by the Luxembourg Institute of Socio-Economic Research (LISER) and APPLICA, together with the European Social Observatory (OSE).

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Summary

Since 2005, Bulgaria has made many changes in the funding of its social protection system. This has been a period of significant reforms in taxation, social security contributions and pensions, and there have been attempts to reform other systems, such as the funding of healthcare and disability. The period was also marked by the Great Recession, which affected Bulgaria some time after it hit the leading economies: in Bulgaria, there was a big slowdown in 2009, which continued at least until 2013, although the effects of the Global Recession were still being felt in 2015 (and even beyond).

As a result of the cumulative forces of tax cuts, the economic downturn from 2009 and the subsequent recovery, revenues from taxation and social contributions, measured as a proportion of GDP, have followed a U-shaped curve in the period since 2005.

From 2005, Bulgarian governments pursued a course of reducing social security contributions: the total rate of social contributions paid by employers and employees fell from 35.5% in 2005 to 22.5% in 2010. In the same period, social contributions paid by the self-employed fell from 29% to 16% of insurable income. In 2011, the government was forced to increase social insurance rates by 1.8% in the face of the clear long-term unsustainability of the unfunded pension system and the national budget, which put pressure on employment in the wake of the Great Recession. In 2008, Bulgaria introduced a proportional (flat) income tax of 10%, without any tax credits or exemptions for low incomes. Since 2005, there has been a significant change in the financing mix for social protection. The share of general government contributions rose from 36.1% in 2005 to 46.3% in 2016, peaking in 2010 at 51.2%, just before social security contributions were raised.

Since 2015, public finances have stabilised. An on-going pension reform to increase pensionable age, combined with several hikes in social security contribution rates, has stabilised the long-term projections for the sustainability of the statutory unfunded pension system, which is the largest social security expenditure. Long-term projections remain very sensitive to expectations concerning migration, fertility and life expectancy, and to the level of economic activity; but the remaining risks are moderate to low under the current policies and general trends.

The largest long-term risk for the sustainability of public finance and social protection expenditure comes from healthcare. There is a large rate of non-participation in the health insurance system, with the estimated number of persons without health insurance standing at about 900,000. Attempts to rebalance the territorial distribution of hospitals and to contain the deficit for hospital treatment have so far met with little success. Bulgaria spends a very large proportion of the healthcare budget on treatment, and far less on prevention and the promotion of healthy life styles. Private costs for health are among the highest in the EU, and the system as a whole has many inefficiencies and is a major generator of inequality.

Bulgaria has no well-defined long-term care system with clear sources of funding. Currently, the funding of long-term care is split between healthcare and disability benefits, with no clear delineation and with many service gaps. Investment in the underdeveloped long-term care system has the potential to improve efficiency, by diverting the burden of care away from the expensive hospital system.

In view of the increased importance of revenue from general taxation to fund both pensions and healthcare, it will be very important to introduce more progressivity in direct taxes and to increase the scope of means-tested benefits, which currently absorb a very small proportion of expenditure. Social contributions – and in particular contributions for healthcare – can also be made more progressive by raising or removing ceilings and by offering some additional support to the poor who have accumulated unmanageable arrears on health contributions.

1 Current levels and past changes in financing social protection

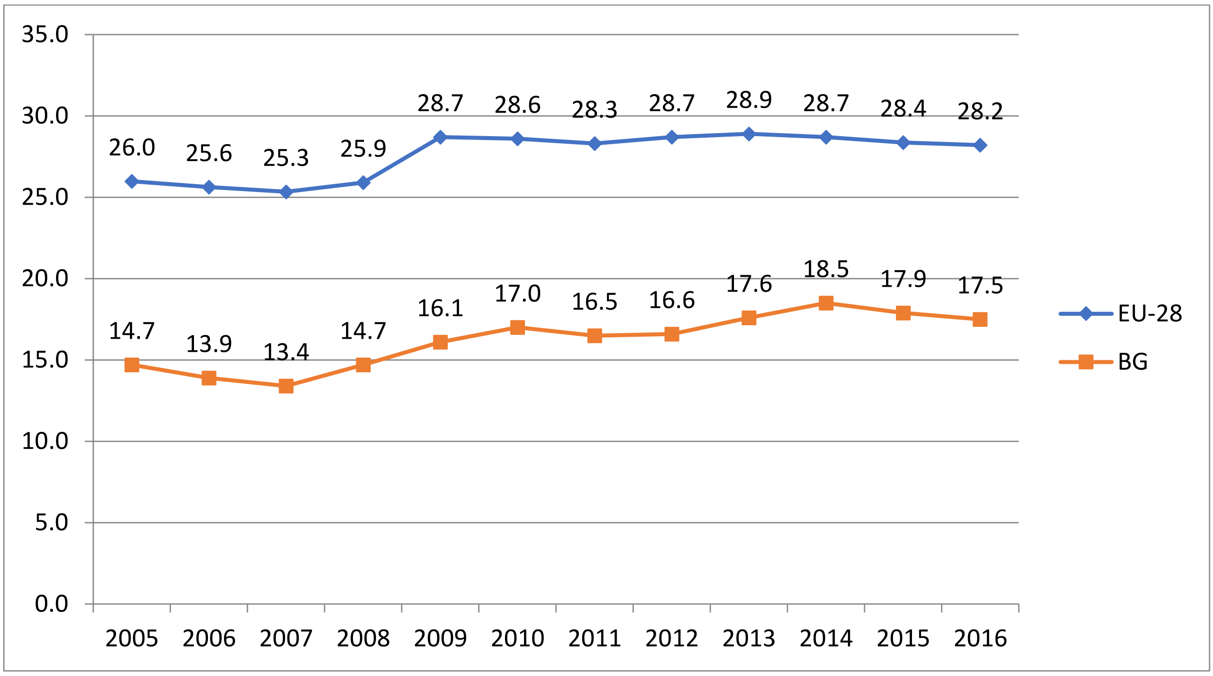
The period since 2005 has been marked by constant and significant changes in the Bulgarian economy and by substantial reforms in many sectors, including taxation and the financing of social protection. The period was also marked by the Great Recession, which affected Bulgaria some time after it hit the leading economies, with a major slowdown starting in 2009. Recovery began in 2013, but effects of the Global Recession were still being felt as late as 2015.

In Bulgaria, gross expenditure on social protection does not differ from net expenditure. Neither taxes nor social contributions are levied on any kind of social transfer, including pensions. Changes in the share of gross expenditure on social protection in total GDP in Bulgaria follow the same trend as in the EU, with almost the same pattern, though spending remains at a significantly lower level. Overall the share of gross expenditure has increased since 2005 from 14.7% to 17.5% of GDP (Figure 1). The main drivers for the increase are the rising expenses of pensions and healthcare: both were initially designed to be funded on the basis of contributions – called in Bulgarian legislation 'social contributions' and 'health contributions'. The two types of contributions are managed by separate independent agencies with their own boards: the National Social Security Institute (NSSI) and the National Heath Insurance Fund (NHIF). The rates for social and healthcare contributions are determined separately: the budgets of the NSSI and NHIF are set each year by two special laws, as part of the overall budgetary process. Over the years under consideration (2005-2018), the budgets of both the NSSI and the NHIF came under increasing strain and required growing transfers by government from general taxation. In 2008, the overall transfer from the general government to the NSSI was about EUR 750 million, while by 2018 it had grown to EUR 2.14 billion.[1] In 2008, the NHIF received a transfer of EUR 106 million from the state budget (general taxation); in 2018, the transfer amounted to EUR 6,453.46 million. So the parallel developments in both these sectors, as described above, contributed to a shift in financing from social contributions to general government contributions. In the period after 2005, healthcare costs were on a constant upward trend, due to the proliferation of hospitals, which led to the oversupply of hospital care in big cities. This oversupply led to high rates of hospitalisation and inflated costs for healthcare and low investment in the relatively underdeveloped preventive care.

Pension reform – increasing pensionable age by two months per year – effectively started in 2016. The number of pensioners decreased marginally from 2,302,000 in 2005 to 2,158,000 in 2018, while the average pension kept rising with inflation and the growth of the average wage. Between 2005 and 2018, overall expenditure on pensions grew by 2.6 times in nominal terms, from EUR 1.874 billion to EUR 4.835 billion. Since the introduction of a 10% flat income tax in 2008, the Bulgarian taxation system has not offered any tax breaks with a social purpose (OECD, 2016), tax credits or tax allowances. The only exception is a small child tax allowance, which allows families to reduce their tax base by 200-600 Bulgarian lev (BGN) (EUR 102-307) for each child up to the third (the law does not provide incentives to have more than three children); this means that a family with taxable income pays about EUR 10 less per child per year in tax.

[1] This comparison requires a number of disclaimers, as comparison through years is complicated by legal changes and apparent changes in accounting practice. The government pays social security contributions for public employees. In addition, in some years the government was 'a third insurer': instead of making a transfer, it was participating in the payment of contributions for some categories of insured persons, so the transfer was 'hidden' within other items on the budget. In the quotation above, the whole amount of the transfer was taken from the approved early budgets. In an analysis of transfers made from 2000 to 2010, the Ministry of Finance provides even lower estimates of the transfers made from the general government to the social security budget between 2005 and 2010 to explain the need for raising social security contributions (Ministry of Finance, 2010).

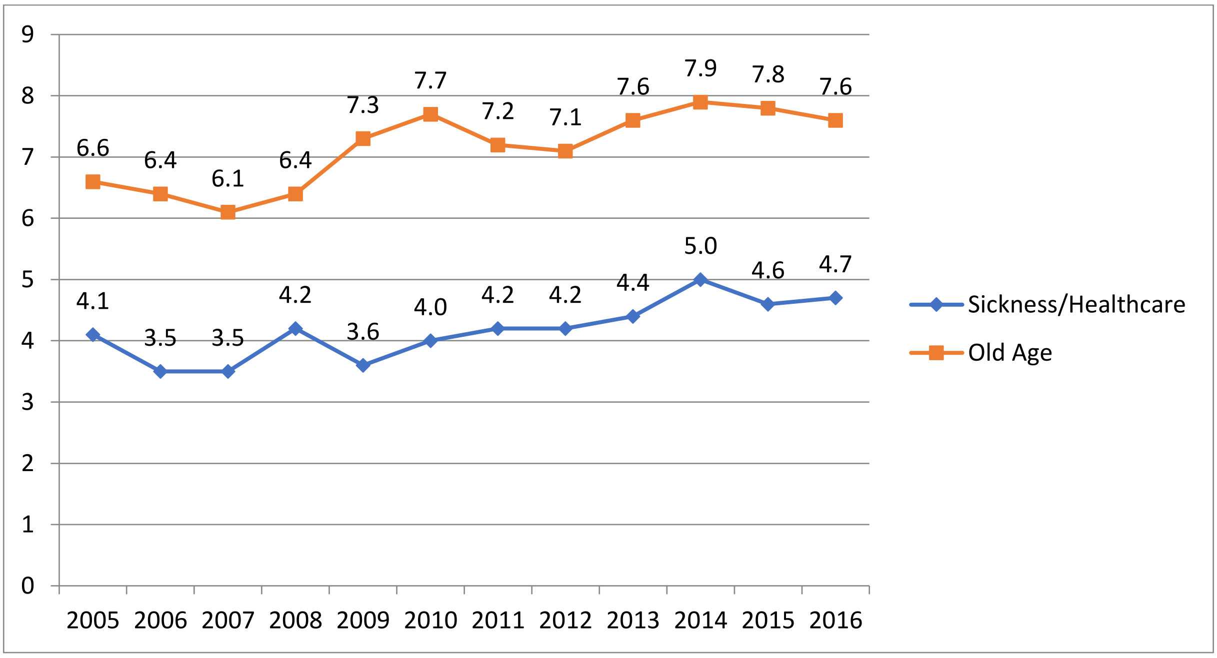
Figure 1. Share of gross expenditure on social protection in total GDP, 2005-2016



Source: Eurostat, European System of Integrated Social Protection Statistics (ESSPROS) tables.

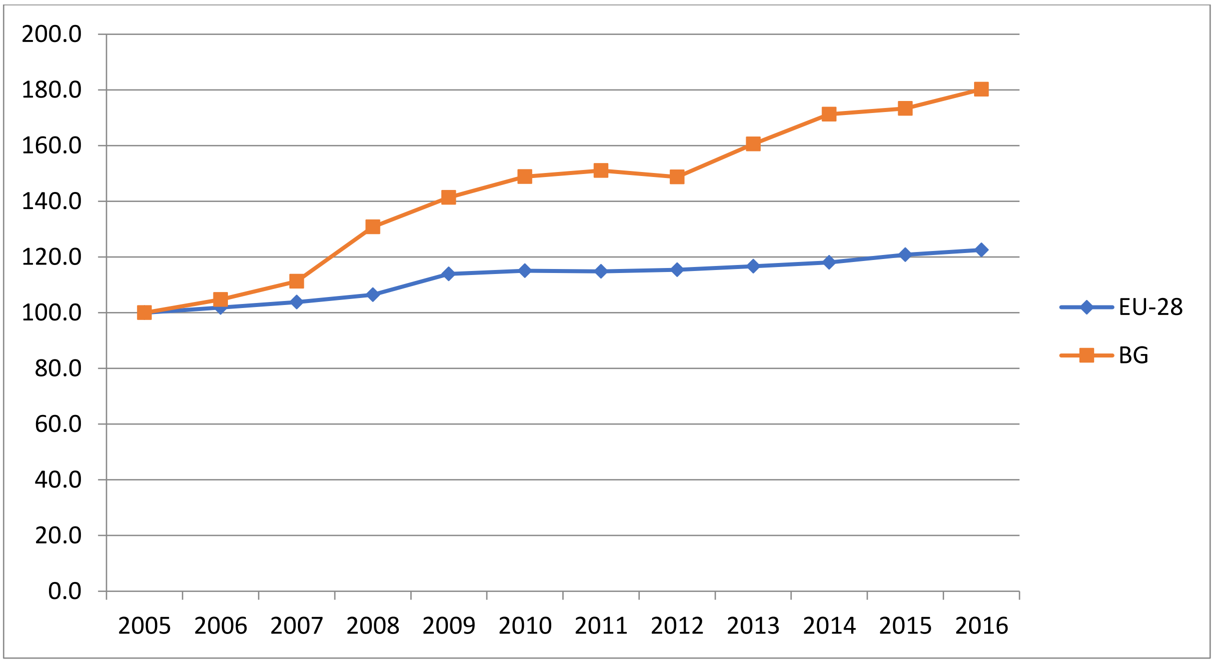
The trend in gross expenditure on social protection (Figure 1) bears the clear mark of the economic recession, which was first felt in Bulgaria in 2009 and led to protracted stagnation. The rise in the share of public spending in 2009 was due primarily to a contraction of output (a 3.6% decrease in GDP), rather than to an increase in the amount of social protection expenditure in constant prices. The next few years up until 2014 were characterised by low growth of between 0% and 2%. True recovery started in Bulgaria in 2015, but pre-recession output was not reached until 2018 and the projections are it will not be reached any time soon.

Figure 2. Share of gross expenditure on old age and sickness/healthcare in total GDP, 2005-2016



Expenditure on both sickness and healthcare and old age has grown relative to GDP. Expenditure on the old- age function grew by 1% of GDP: from 6.6% in 2005 to 7.6% in 2016, reaching its highest level in 2014, just before the reform to increase pensionable age started. In the same period, the share of expenditure on healthcare and sickness increased by 0.7% of GDP, peaking at 5% of GDP in 2014 and finishing at 4.7% of GDP in 2016. The pattern of evolving healthcare expenditure is a result of one-off efforts to contain healthcare costs, and especially the costs of hospital care; but these efforts usually last for one budgetary year – the following year the government has to save public (state or municipal) hospitals facing closure by covering their debts. Bulgarian healthcare faces structural challenges that no government has yet managed to address. The main challenges include large territorial imbalances in the distribution of healthcare resources in both hospital and outpatient care: a proliferation in the number of hospitals in urban areas, while hospitals in less-populated and remote areas struggle to survive. For both functions, the main reason for the falling share of costs in GDP after 2014 has been stronger economic growth, which started to pick up after the shock from the Great Recession.

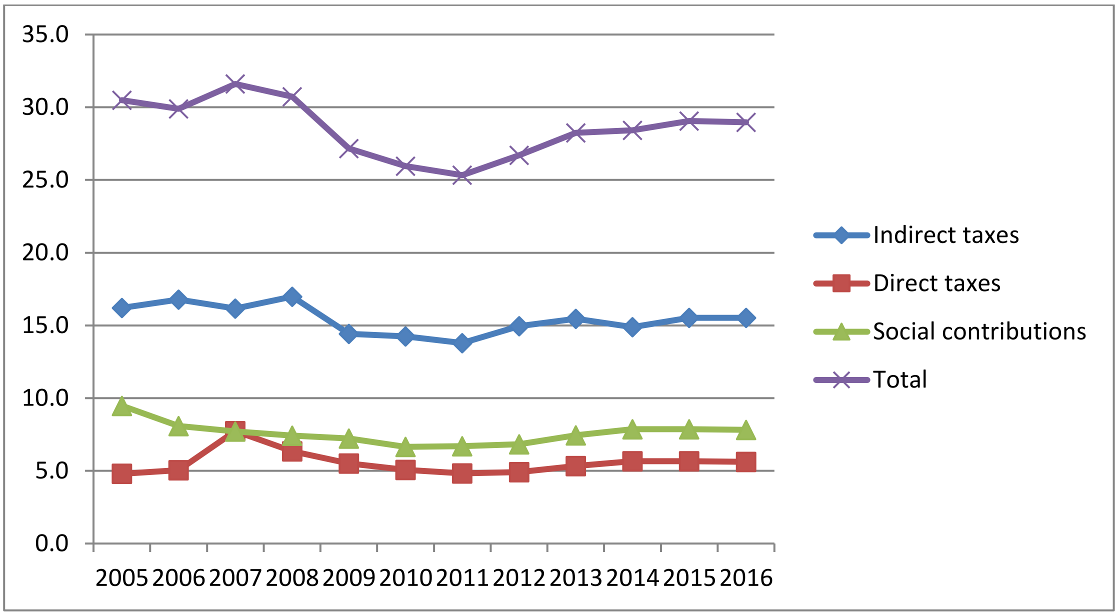
Figure 1. Gross expenditure on social protection in real terms (i.e. at constant 2005 prices), 2005-2016



Gross expenditure on social protection in real terms grew at a very high rate after 2005, poising only during the first years of the Great Recession, but then picking up again and significantly outpacing average growth in the EU-28. The reason for this growth is twofold. In the period up to 2008, Bulgarian GDP grew much faster than the EU average, while expenditure on social protection grew even faster, driven by spending on pensions and healthcare. In the period after 2011, expenditure continued to grow as a share of GDP. Although in this period growth was much slower than in 2005-2007, Bulgaria had years of very low inflation (and deflation), which drove up the purchasing power of social protection transfers. And so, the rapid growth in social protection expenditure (at constant prices) was driven by a combination of GDP growth (in some periods) and deflation (in other periods), against a background of long-term rising costs.

In Bulgaria, tax on consumption is the only source of revenue that exceeds the EU average as a share of GDP. This has important consequences for the financing of social protection.

Figure 4. Taxation trends in Bulgaria for the period 2005-2016 (% of GDP for each main source of revenue)

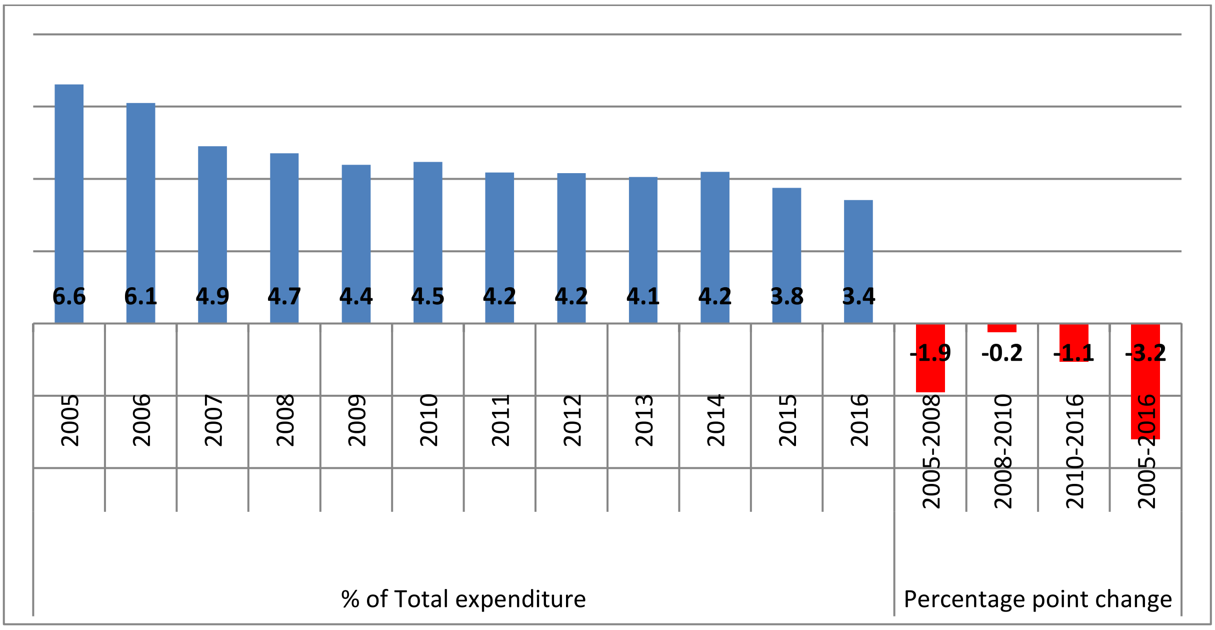


Source: European Commission, Data on taxation.[2]

Budgetary revenue in Bulgaria depends heavily on indirect taxes, the most important of which is VAT (Figure 4). Social contributions take a slightly higher share of GDP than direct taxes. The weight of indirect taxes in the mix is evident also from the pattern of change of overall revenue, which closely follows that for indirect taxes. In general, however, changes since 2005 have been insignificant, and no major shift is discernible at the aggregate level, apart from a decrease in overall revenue at the time of the Great Recession, followed by a gradual recovery. Despite partial synchronicity, the drop in revenues cannot explained entirely by the effects of the Great Recession: it is also strongly affected by previously implemented policies to cut direct taxes and social security contributions. This pattern is in line with the findings of Bontout and Lokajickova (2013) of initial anticyclical response in many European countries, followed by a reduction in social expenditure. However, in the case of Bulgaria, what appears as a response to the crisis was to some extent also a response to the previous excessive reduction in taxation, which rendered the public budget unsustainable in the long run. Public revenue in Bulgaria measured as a share of GDP is among the smallest in the EU: with a total revenue of 29% of GDP in 2016, Bulgaria was ranked 28th in the EU.

[2] https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en

Figure 5. Share of expenditure on means-tested benefits, 2005-2016



Source: Eurostat, ESSPROS database.

The share of expenditure on means-tested benefits decreased from 6.6% to 3.4% over the period 2005-2016, following an almost unbroken downward trend (Figure 5). The reason for this is that means-tested transfers in Bulgaria do not follow any indexation rules. Means-tested transfers (with the exception of child benefits) are linked to the Guaranteed Minimum Income (GMI), the updating of which is at the discretion of the government and occurs approximately once every 10 years. By contrast, wage- and price-indexed transfers have usually moved far upwards over such a long period.

Since 2005, there have been no major changes in the breakdown of gross expenditure on social protection by function. In the period 2005-2016, expenditure on old age – the most important function in terms of expenditure – accounted on average for a little more than 45% of gross expenditure (Figure 6). The growth of expenditure was mainly driven by an overall increase in the average amount of pensions. The share of 'other' functions in overall expenditure increased by 3.6 percentage points (pp) in the period 2005-2016, and there was a reduction in the share of expenditure on sickness and healthcare. This may have been driven by two factors. The first was an increase in the GMI in 2009 of about EUR 5 (from about EUR 28 to about EUR 33). Many means-tested social transfers, including social pensions, are linked to the GMI. The other factor was an effort by the new government (which came to power in 2009) to contain the costs of healthcare by various means, e.g. placing a cap on hospital expenditure in the face of unmanageable deficits incurred by many public hospitals. These extraordinary (but unsustainable) measures had only a temporary effect, but they may have had an impact for a couple of years on the balance of expenditure in the overall mix. Expenditure on healthcare in Bulgaria is subject to large fluctuations, depending on discretion and on negotiations over the price of medications covered by the health insurance budget. Discretionary surges in spending depend on when a government decides to put additional money into the system to pay off part of the deficits regularly accumulated by public hospitals. Usually this happens when there is the prospect of a hospital closing – either a strategically important one in a large city or one in a municipality where it is the only nearby healthcare provider. Such cases usually constitute a political emergency, with the threat of public protests.

Figure 2. Breakdown of gross expenditure on social protection by function, 2005-2016 (% total expenditure)

Source: Eurostat, ESSPROS database.

In the category of 'other' social expenditure, the family and disability functions play a more important role. Child benefits enjoy high coverage, though not universal, and are therefore subject to increased public interest and demand: they are uprated more often. But their large scope reduces their redistribution effects and progressivity. The disability function is another with a relatively high weight in the mix of 'other' functions. In 2018 and 2019, it again became a subject for heated debate and accusations of mishandling and corruption within the medical expert committees that set the disability levels on which benefits are granted. In 2019, legal changes related to medical disability expertise led to a new categorisation of disability, taking into account only the main diagnosis. These changes were contested by some associations of disabled persons and by the Ombudsman. As of February 2019, it is not clear if the changes will stay and if they will lead to a sustainable decrease in expenditure. The government has provided assurances that the delay in the payment of benefits experienced is simply due to the revamping of the system, and that nobody will see their total benefits reduced as a result of the reform. About 50,000 persons who receive disability pensions and benefits will have to submit a fresh application to the Agency for Social Assistance, which is taking over payment of the so-called monthly supplement for integration.

2 Current mix and past changes in the sources of financing social protection

The main sources of funding for social transfers in Bulgaria are social security and health contributions, and general taxation. All contributions are collected by the National Revenue Agency and are managed (as stated above) by the NSSI and the NHIF.

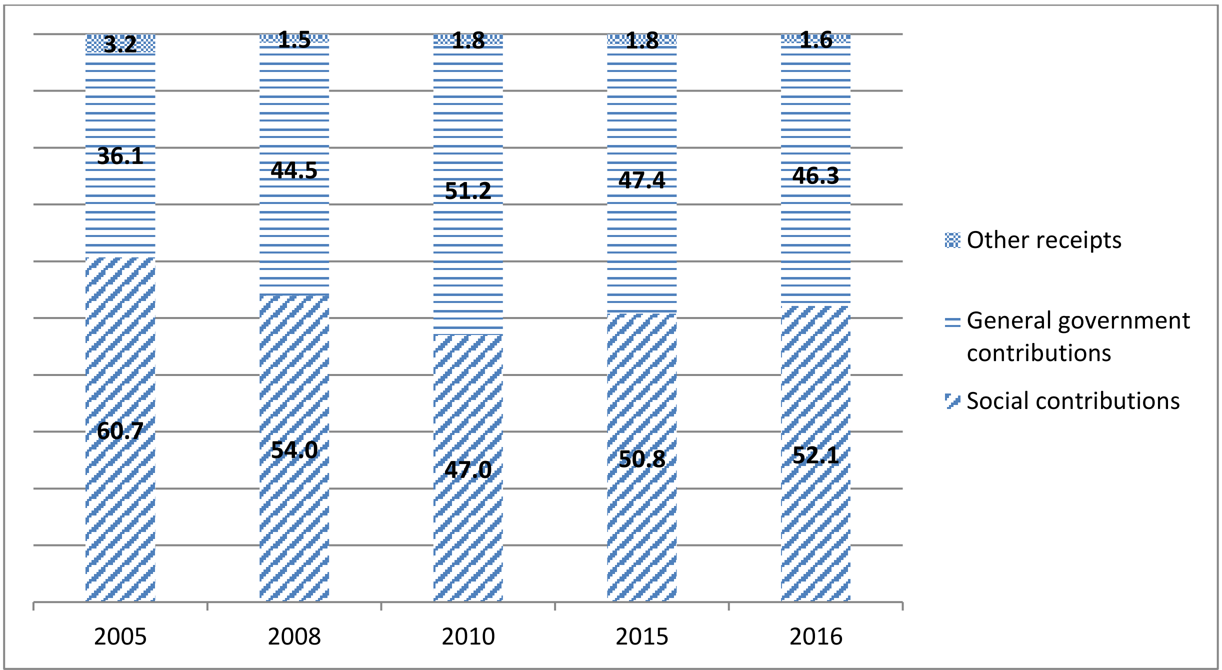
The budgets of the NSSI and NHIF generate large deficits, which are covered from general taxation via transfers from the state.

Contributions are paid for specific groups of risks, which are covered by special funds. The expenditure of the NSSI is split between several funds covering various risks. The different funds cover: a) pensions (with separate funds for social pensions and early retirement pensions); b) maternity and sickness; c) unemployment; d) occupational injuries and occupational diseases. The specific risks covered by the separate funds are designated as a specific share in the overall social security contributions paid by the employer, employee or the self-employed. Such is the case with the non-mandatory contributions covering maternity and sickness paid by the self-employed (see Table 2) and the mandatory contributions for occupational injuries and diseases paid by employers, which have rates of between 0.4% and 1.1% of the gross insurable income for each of a total of 99 occupational groups.

In 2011, social insurance rose by 1.8 pp after several years of falling rates and discussions about the need for a much larger increase. The main reason for the step was to stabilise the social security system, which had previously been destabilised by a policy for the continued reduction of social security contributions, in an effort to boost employment and investment. These policies underestimated the damage resulting from the deficits that arose in the system and from compromising the existing social security model. They also did not factor in cyclical risks. Thus, the government was forced to increase social security contributions in the face of the looming recession, at a time when this was very likely to inflict further damage on an already faltering labour market.

In 2009, also forced by the financial crisis, the government intervened in social security as 'a third insurer', paying a contribution equal to 12% of the income of each employed person. This was partly done for administrative reasons – to make transfers from general revenue easier to trace and forecast – but mostly for the sake of preserving the semblance of a Bismarckian social security model still up and running. The revenue from these 'social security premiums' paid by the state was reported in the budget of the National Social Security Institute as social security contributions, instead of transfers from the government. From 2016, parliament discontinued this accounting stratagem, and since then the transfers from general taxation have been accounted for what they actually are.

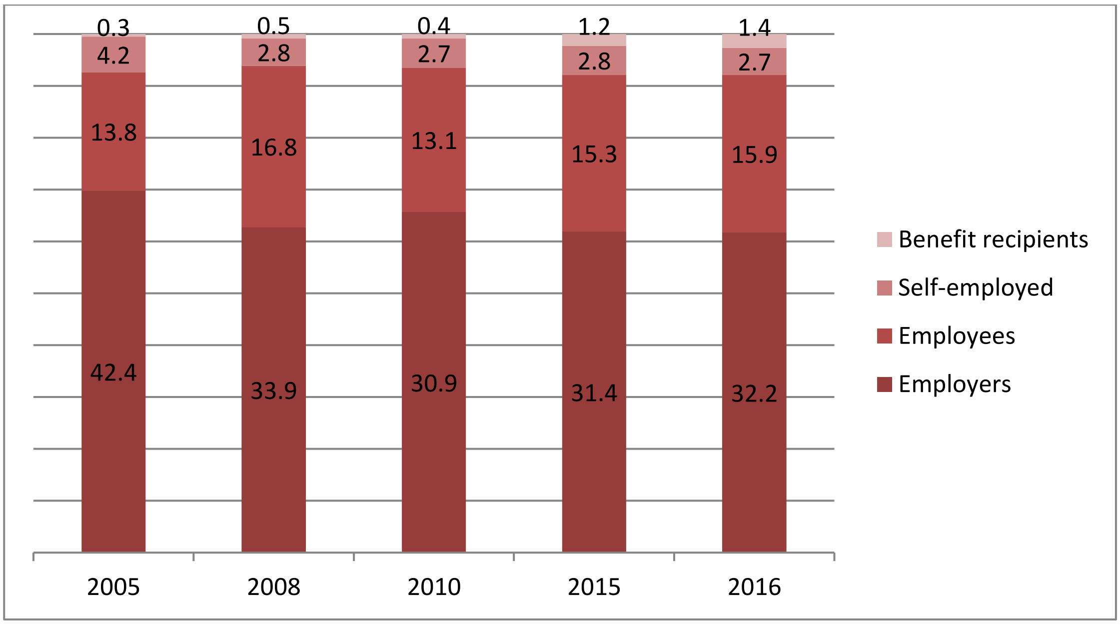
Figure 7. Division of financing for social protection by main source, 2005-2016 (% total financing)



Source: Eurostat, ESSPROS database.

The share of social contributions in the financing of social protection decreased from 61% in 2005 to 47% in 2010, due to increasing deficits in the statutory pension scheme, which were covered from general revenue. From 2011, social security contributions were raised and their share increased by several percentage points, but they never reached the 2005 level (Figure 7). However, this did bring the share of social contributions back above the 50% line. General government contributions originate mainly from indirect taxes, with a modest role played by direct taxes. Bulgaria does not have any earmarked taxes.

Figure 8. Breakdown of social contributions by employers, employees, self-employed and benefit recipients, 2005-2016 (% total financing)



Source: Eurostat, ESSPROS database.

The share of employer contributions in total financing decreased by 10 pp in the period 2005-2016. This was driven by a policy of adjusting the distribution of social security contributions between employers and employees. Details about the social contributions for each year in the period 2005-2019 are given in Table 1 and Table 2.

Table 1. Social security contributions by employers and employees, maximum insurable income and minimum wage (2005-2019)

Year	Employee (%)	Employer (%)	Total (%)	Maximum insurable income (BGN)	Minimum wage (BGN)
2005	10.65	24.85	35.5	1300	150
2006	10.325	19.175	29.5	1400	160
2007	10.325	19.175	29.5	1400	180
2008	10.6	15.9	26.5*	2000	220
2009	9.8	12.7	22.5	2000	240
2010	8.9	11.6	20.5	2000	240
2011	9.7	12.6	22.3	2000	240-270
2012	9.7	12.6	22.3	2000	270-290
2013	9.7	12.6	22.3	2200	310
2014	9.7	12.6	22.3	2400	340
2015	9.7	12.6	22.3	2600	360-380

2016	9.7	12.6	22.3	2600	420
2017	10.14	13.16	23.3	2600	460
2018	10.58	13.72	24.3	2600	510
2019	10.58	13.72	24.3	3000	560

Social contributions covering accidents at work and paid fully by the employer are not included.

For persons born after 1959 in 2005-2006, 4% of contributions went to a private funded scheme; after 2007, 5% of contributions went to a private funded scheme. Since 2016, people have been able to opt out of the private funded scheme and pay their whole contribution to the state unfunded scheme.

**The decrease to 26.5% happened from 1 October 2007.*

Source: National Revenue Agency, own calculations.

The rate of contributions paid by the self-employed became more and more aligned with the combined rates of contributions paid by employers and employees (Table 2).

Table 2. Social security contributions and minimum insurable income for the self-employed (2005-2019)

Year	Social security contributions (%)	Social security contributions including maternity and sickness	Minimum insurable income (BGN)
2005	29	32	220
2006	23	26.5	220
2007	23	26.5	220
2008	22	25.5	240
2009	18	21.5	260
2010	16	19.5	420
2011	17.8	21.3	420-550*
2012	17.8	21.3	420-550
2013	17.8	21.3	420-550
2014	17.8	21.3	420-550
2015	17.8	21.3	420-550
2016	17.8	21.3	420-550
2017	18.8	22.3	460-600
2018	19.8	23.3	510
2019	19.8	23.3	560

**From 2011 to 2017, the minimum insurable income for the self-employed was determined on the basis of the income from the previous year.*

Source: National Revenue Agency, own calculations.

2.1 Old age and survivors

Social contributions for pensions vary between ordinary jobs and two categories of hazardous and arduous jobs. For ordinary jobs, the current contributions amount to 19.8% of gross earnings: 7.92% is paid by the employee and 11.88% by the employer. Persons born after 1959 pay 5% of their gross earnings to a private funded scheme. The overall percentage of social contributions and the distribution between employer and employee is the same as for persons born before 1960.

If the insured person works in the second or the first category of labour (in ascending order or arduousness or hazardousness), the employer pays an additional contribution of 3%. Employees working in the first and second categories of labour only are subject to compulsory supplementary pension insurance in professional funds amounting to 7% or 12% of gross earnings, depending on the category. Contributions to professional funds are paid solely by employers. Workers who fall under the first and second categories of labour are entitled to early retirement after 10 or 15 years of work.

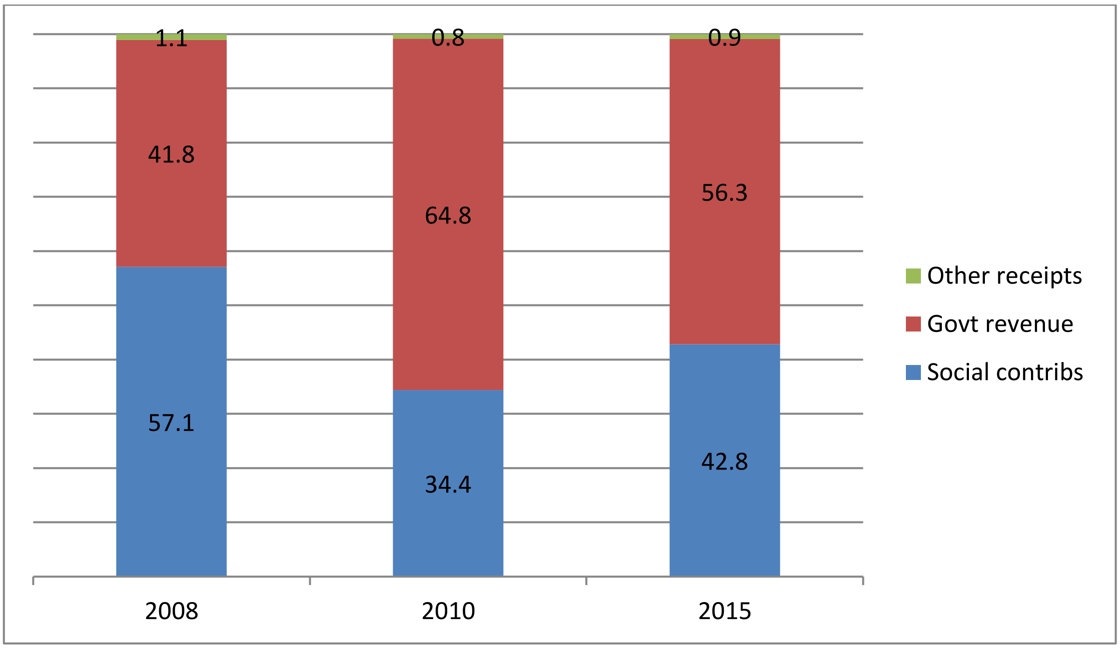
For soldiers and military personnel, civil servants within the system of the Ministry of the Interior (policemen, firemen, police investigators, etc.) and investigators within the judicial system, social security contributions amount to 62.8% of gross earnings; this is entirely financed by the state budget or the judiciary budget, respectively (MISSOC). For those born after 1959, 5 percentage points of the contributions go to a private funded pension scheme.

The self-employed pay social contributions to the amount of 19.8% of the insurable (contributory) income. Again, 5 percentage points of contributions paid by those born after 1959 go to a private funded scheme. The minimum amount of the contributory income for the self-employed in 2018 was BGN 510 (EUR 261) per month. The ceiling for all categories of insured persons in 2018 was BGN 2,600 (EUR 1,329) per month (MISSOC).

Survivor pensions use the same sources of revenue as old-age pensions. Survivors receive different proportions of the pension – ranging from 50% (one survivor) to 100% (three survivors receiving a third each) – of the pension or a similar proportion of the highest invalidity pension, if the deceased had not yet retired.

Old-age and survivor pensions are covered from social contributions. Transfers from general taxation cover the deficit of the NSSI. There are no differences in the sources of funding for the two functions.

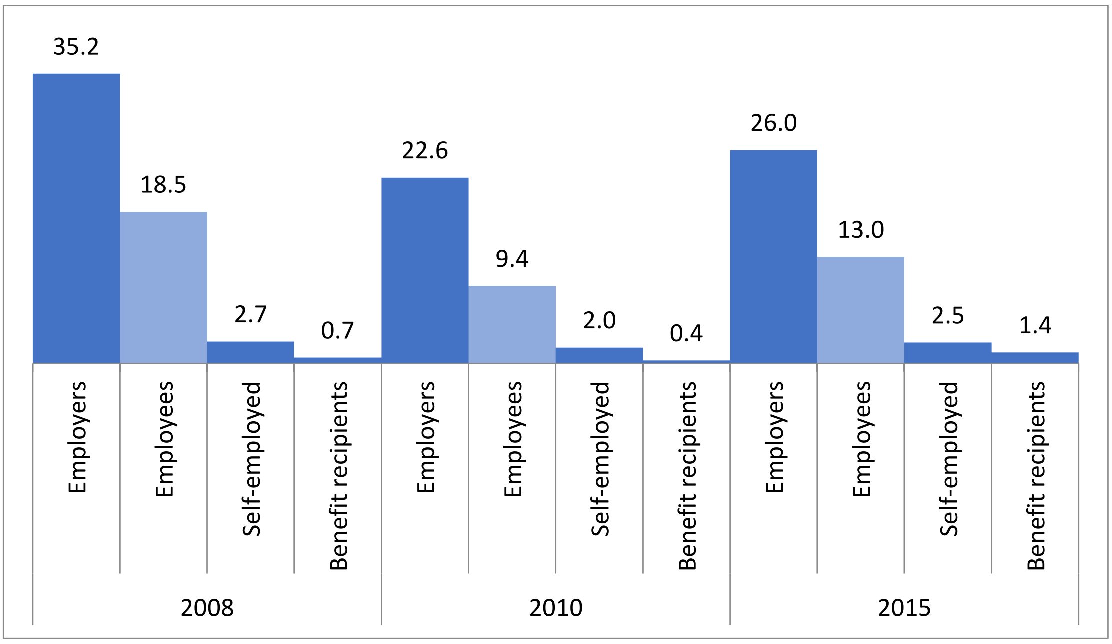
Figure 9. Division of financing of old-age benefits by main source, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

In 2010, almost two-thirds of old-age benefits were financed from government revenue, an increase from 42% in 2008 – although initially (at the end of the last century), the statutory pension system was designed to be sustainable and funded primarily from social contributions. After 2007, a series of cuts in contributions significantly reduced revenue, and the government had to make larger and larger transfers to the budget of the NSSI, which explains the increased importance of government revenue in the 2010 mix of sources of financing. After 2010, the policy trend was reversed and social security contributions were increased several times by 1-2 pp. In the long term, government revenue will likely continue to dominate in the financing of old-age benefits.

Figure 10. Breakdown of the financing of old-age benefits by social contributions by sub-category, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

The ratio between employers and employees has remained relatively stable since 2008 (approx. 2:1). This ratio will very likely not change much in the future.

2.2 Healthcare and sickness

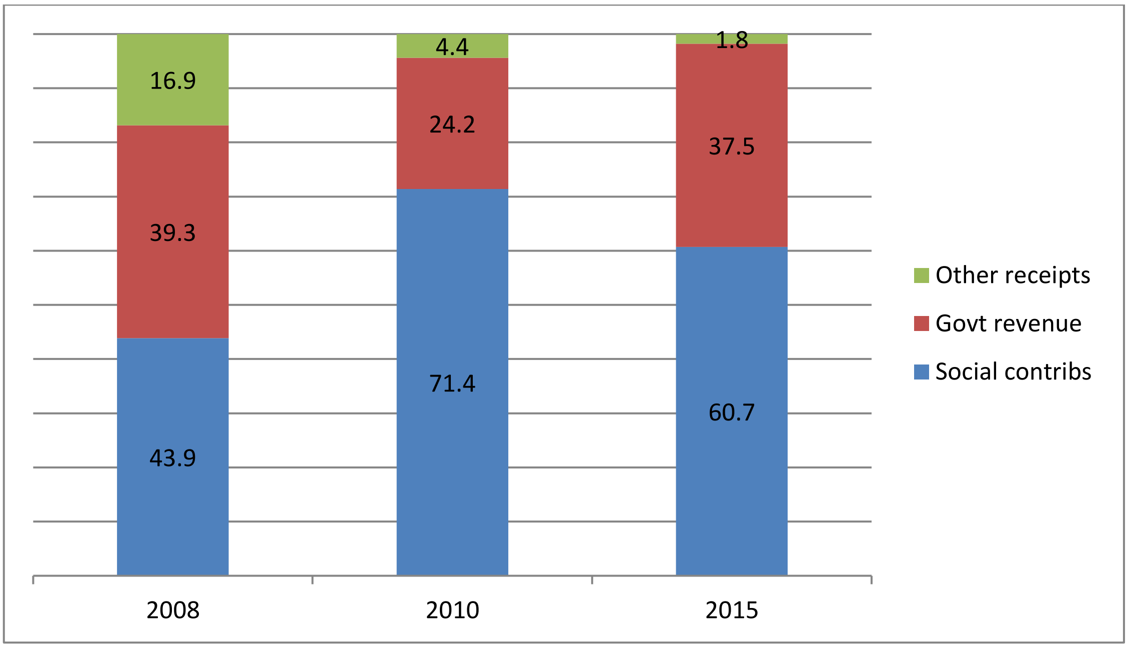
Healthcare is funded through special health insurance contributions which are managed by a National Health Insurance Fund (NHIF), which has a separate budget. The NHIF negotiates regulated prices, concludes framework contracts with medical associations, contracts hospitals and other medical facilities and medical practices which provide services. Health contributions are proportional (flat): the amount of the contribution is 8% of gross earnings for both employed persons (3.2% paid by the employee and 4.8% by the employer) and the self-employed. The minimum amount of the contributory income per month varies according to occupation and industrial branch. For the self-employed in 2018 and 2019, it was set equal to the minimum wage: BGN 510 (EUR 261) in 2018, BGN 560 (EUR 286) in 2019. The ceiling is the same as for social security contributions: in 2018 the ceiling was BGN 2,600 (EUR 1,329) per month; in 2019 it is BGN 3,000 (EUR 1,534) per month. The budget of the NHIF for 2019 is BGN 4.3 billion (EUR 2.2 billion). About a third of this budget comes from transfers made by the government – almost BGN 1.4 billion (EUR 716 million) are so-called transfers for health insurance, and an additional BGN 43 million (EUR 21.99 million) come directly from the budget of the Ministry of Health. The transfers for health insurance are meant to cover the healthcare costs for children and the retired, who are considered to be insured by the state. The money actually comes from general taxation.

Those who are not covered by the health insurance system on any other grounds are obliged to pay contributions amounting to at least 8% of the minimum contributory income for the self-employed – BGN 510 (EUR 261) per month – at their own expense. The actual amount of the health insurance contribution due per calendar year is determined through the annual tax declaration. Insured persons who have made less than four contributions in the last 36 months must pay the provider for medical treatment.

After the insured person pays all the due contributions for the last 60 months, their insurance rights are restored from the day of payment.

In Bulgaria, sick leave is pooled together with maternity in a special fund and funded from social security contributions managed by the NSSI. Cash benefits for sickness and maternity leave are thus covered by social security contributions managed separately from the health insurance system. The self-employed can choose to opt into the sickness and maternity scheme and pay an additional contribution of 3.5 pp on their insurable income (see Table 2 in the previous section for time series and details). Otherwise they can choose to leave these risks uncovered and not have any payments for maternity leave and sick leave. Social contributions for maternity and sickness are mandatory for employees.

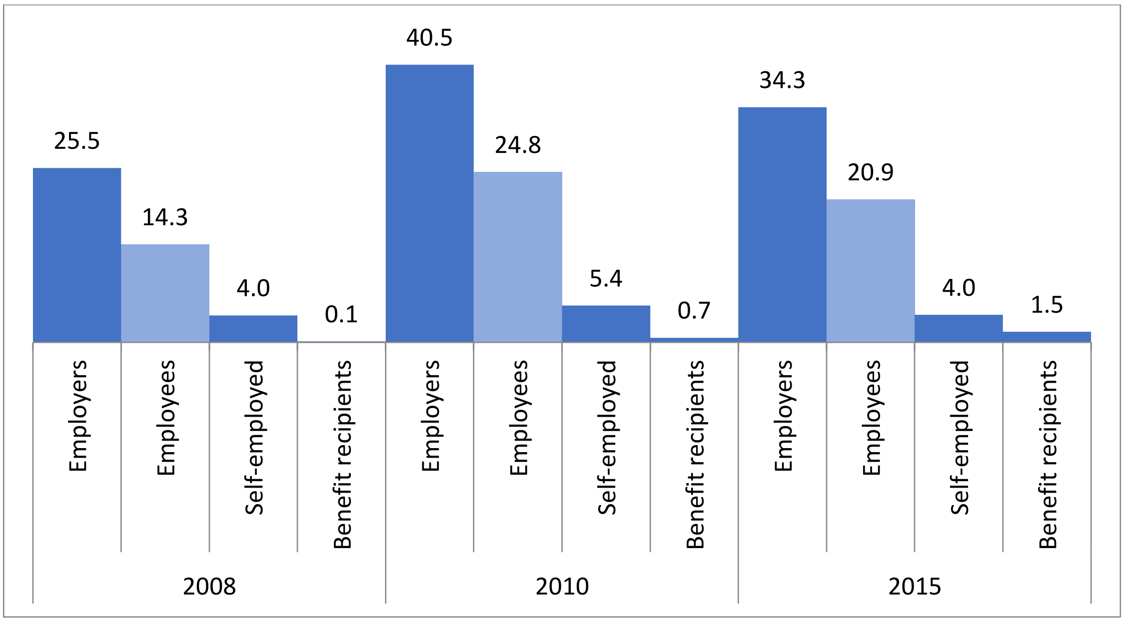
Figure 11. Division of financing of healthcare expenditure and sickness benefits by main source, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

In 2008, social contributions and government revenue had comparable weights in the overall healthcare expenditure and sickness benefits, due to large government transfers to the NHIF following the reduction in contributions. In 2010, the share of healthcare contributions increased. This was due to an increase in the percentage payable for healthcare contributions from 6% to 8% in 2009. As a result, the budget of the NHIF increased substantially in 2010, to EUR 1.315 billion (compared to EUR 862 million in 2008). This increase was due to revenue from increased contributions, which dwarfed other sources of revenue. Since then it has remained at 8%, but the share of transfers from the government has started gradually to increase again on account of the spreading deficit. The reasons for that are complex and related both to the rising price of medications, the new medical technologies and the excessive number of hospitals in urban areas which have contracts with the NHIF, following several unsuccessful attempts to contain their number by enforcing a National Healthcare Map. The first three days of sick leave are paid by employers, so they make a small contribution in the overall mix of healthcare expenditure and sickness benefits shown in Figure 11. Even together, sick leave benefits and maternity benefits generate a relatively small yearly deficit of about EUR 50 million, which is covered from general taxation.

Figure 12. Breakdown of the financing of healthcare expenditure and sickness benefits by social contributions by sub-category, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

The proportions provided by employers, employees and the self-employed have remained relatively stable, employers covering the largest share in 2008, 2010 and 2015 alike. In 2010, contributions paid by employers peaked at 40% of the total financing for healthcare and sickness, while contributions paid by employees accounted for about a quarter of total financing. This was due to a one-time increase in health contributions; but it seems that in the long term, financing from general taxation will increase in importance. Bulgaria has a large group of persons – estimated at about 900,000 (out of a population of around 7.1 million) – who are not insured and have no access to the healthcare package covered by mandatory health insurance. The uninsured are persons of working age, as children and retired persons are insured by the state. To regain their health insurance rights, they have to pay up to five years' arrears: until 2015 only two years' arrears had to be covered, in order to regain access to the health insurance package.

Long-term care in Bulgaria is not funded by any specific scheme. Long-term care is significantly underfunded; expenditure on this function is spread between healthcare and disability, but it is very difficult to separate this expenditure from other expenditures. This makes long-term care inefficient and more costly, i.e. often cases are reported by hospitals, where patients have to stay for months after treatment due to a lack of appropriate social services and post-treatment facilities.[3]

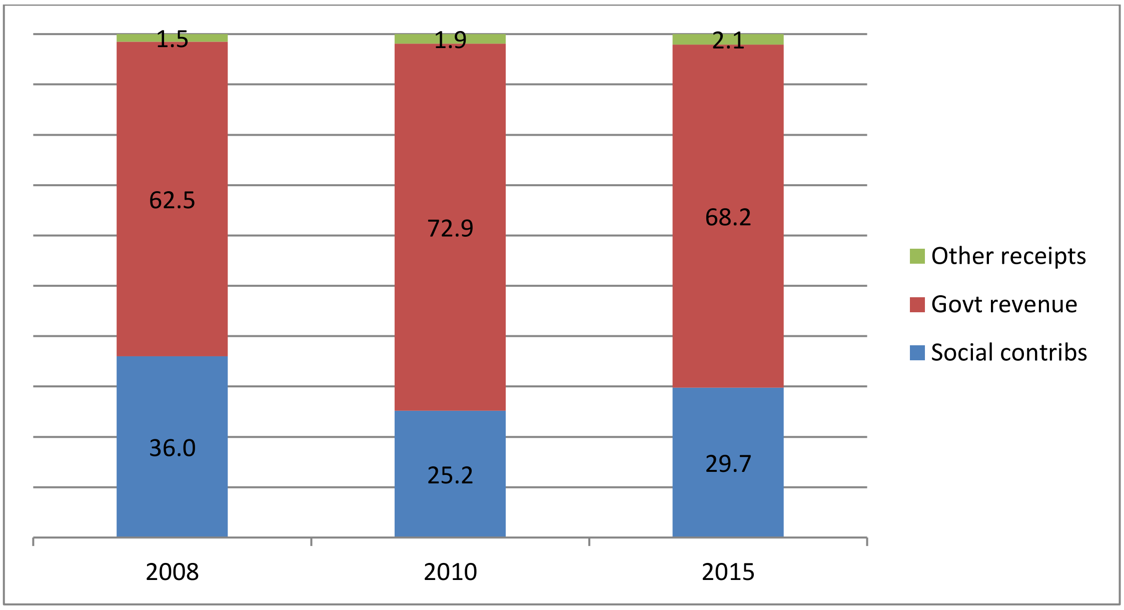
Accidents at work are covered by contributions paid fully by the employer. Insurance contributions covering accidents at work vary according to the risk (between 0.4% and 1.1% of gross earnings).

[3] https://www.dnes.bg/obshtestvo/2018/12/05/izpisvat-gi-ot-bolnica-no-niama-koi-da-gi-pribere.395589

2.3 Disability

Working capacity, or degree of disability, is attested by special medical committees. Incapacity or reduced capacity is categorised in three groups, with the defined percentage of capacity loss ranging from 50% to 100%. The state budget covers 30% of the employer's contributions paid for people with disabilities who are working for employers contracted by the Agency for People with Disabilities, and 50% of the contributions paid for people with disabilities working for specialised enterprises owned by associations of people with disabilities and units for occupational therapy of disabled persons (MISSOC). In 2019, the budget that was allocated for the social protection of persons with disabilities was BGN 437 million[4] (EUR 223 million), following an increase of BGN 150 million (EUR 77 million) after lengthy protests by the mothers of children with disabilities.

Figure 13. Division of financing of invalidity benefits by main source, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

Since 2008, government revenue has started to play a more important role in the funding of invalidity benefits.[5] Between 2008 and 2015, the share of government revenue in invalidity benefits rose from 62.5% to 68.2%, peaking at 72.9% in 2010. Invalidity benefits have raised many concerns about the lack of accountability and corruption in the disability attestation system. Late in 2018, the government undertook a reform of disability attestation, which led to a new categorisation of many diagnoses and fears about the possible withdrawal of, or reduction in, benefits for some groups of disabled despite the assurances given by the government that this would not be the case. In Organisations of persons with disabilities commented that the reform will mostly hurt persons who are really disabled and in need of support, not those involved in fraud.

2.4 Unemployment

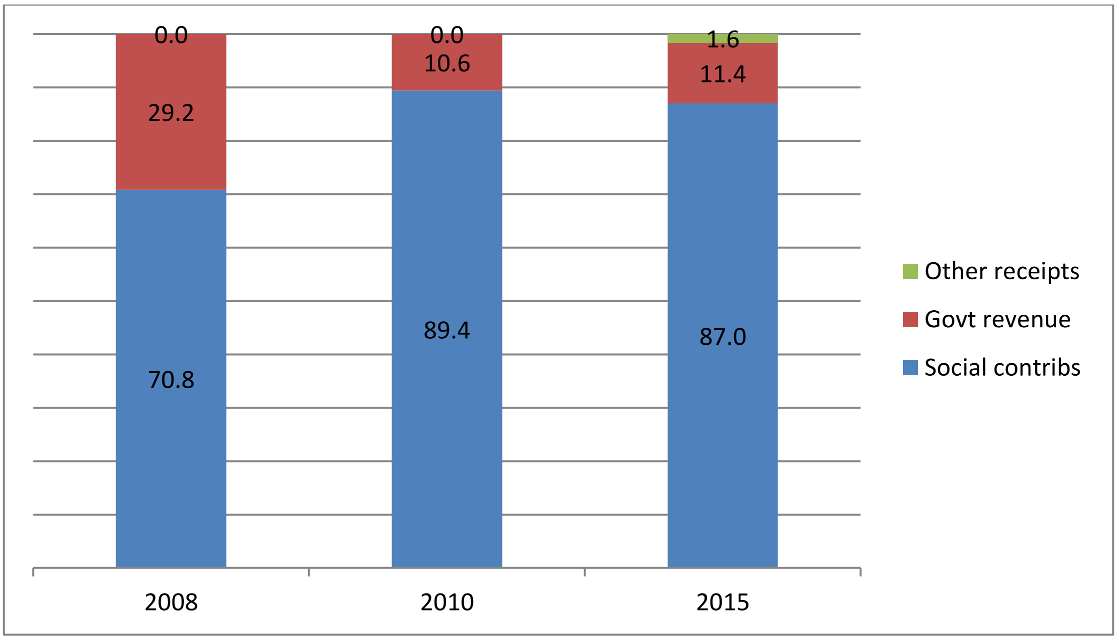
Unemployment is covered by social contributions amounting to 1% of the gross (insurable) income (shared between the employer and the employee in a ratio 60:40) and transfers made from government revenue to the NSSI to compensate for the annual deficit. In Bulgaria, contributions related to unemployment are not levied on any other income,

[4] State Budget Act 2019, State Gazette, 13 December 2018.

[5] Data for 2005 are not available for Bulgaria.

beyond income from employment like dividends, self-employment, etc. Protection against unemployment is only extended to employed persons, i.e. only employed persons can receive unemployment benefits.

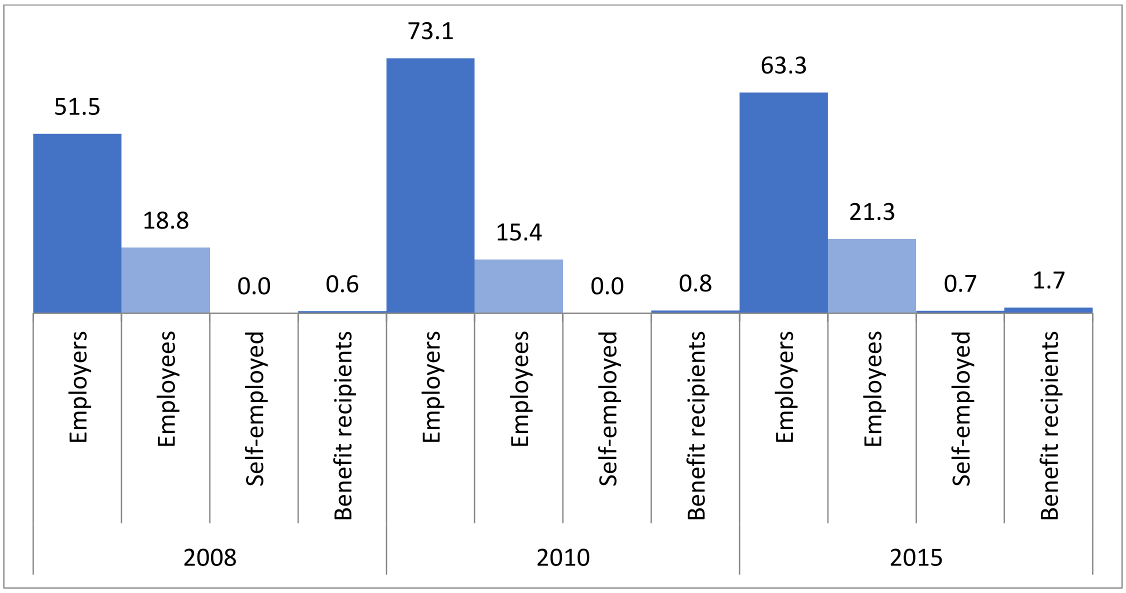
Figure 14. Division of financing of unemployment benefits by main source, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

In 2010 and 2015, the estimated proportion of unemployment benefits covered by government revenue decreased to about 10%, from levels as high as 30% in 2008 and before. The steady decline in unemployment in what, in retrospect, appear to have been the final years of boom before the economic bust contributed somewhat to this development, by reducing the deficit in the social security system; however, the increase in social security contributions played the main role.

Figure 15. Breakdown of the financing of unemployment benefits by social contributions by sub-category, 2005-2015 (% of total financing)



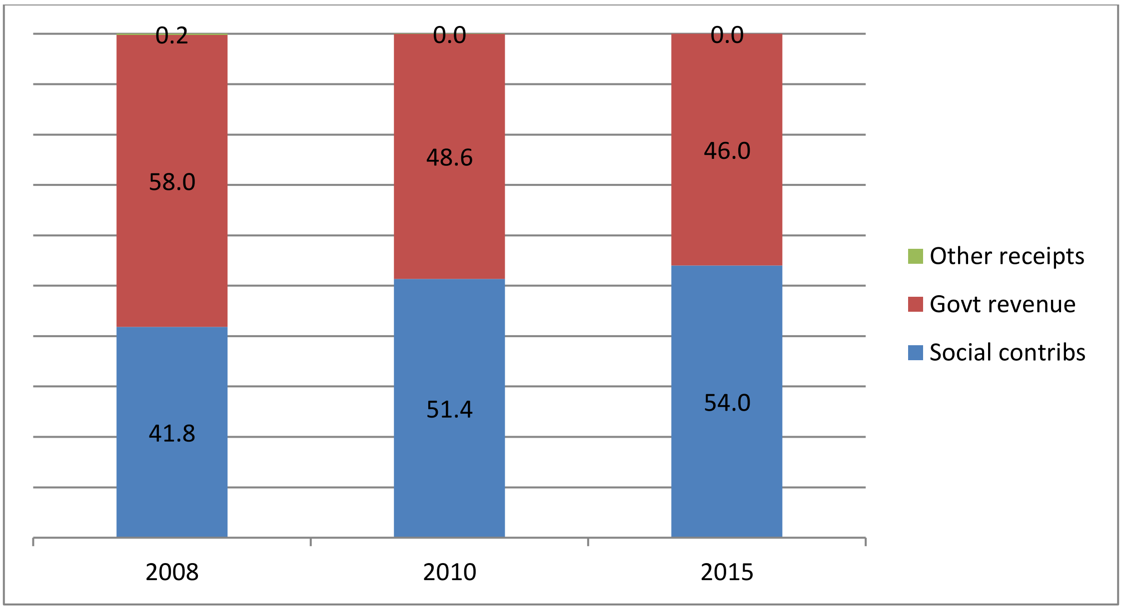
Source: ESSPROS data by scheme, own calculations.

The proportion of expenditure covered by employers and employees increased, due to the overall increase in the share of social security contributions within the mix; but the ratio between employees and employers changed slightly, driven by policies to increase the proportion of social security contributions paid by the employee.

2.5 Child benefits and other family allowances

Child benefits are funded from general taxation, subject to a means test with a rather high threshold (up to BGN 500 or EUR 256 per family member per month). Each family with children up to the age of 18 (or 20, if still attending secondary school) and with a monthly income of less than BGN 400 (EUR 205) is entitled to child benefits. Following a reform introduced in 2018, families in even higher income brackets (between BGN 400 and BGN 500, i.e. between EUR 205 and EUR 256 per family member) now receive 80% of the child benefit. Means-tested one-off and monthly allowances are granted to mothers without social insurance during pregnancy and rearing the child to the age of one. Other types of **family allowances** – such as the one-off allowance for pregnancy and childbirth for mothers who have social insurance and the monthly allowances for rearing a child until the age of two – are funded from social security contributions. Maternity and paternity leave and pregnancy and childbirth benefits are subject to special contributory arrangements, which are mandatory for employees and civil servants and optional for the self-employed. An insured mother has the right to a cash benefit for pregnancy and childbirth for a period of 410 days, commencing 45 days before the anticipated date of delivery. The daily cash benefit is 90% of the daily average contributory income (calculated over the 24 calendar months preceding the leave). The amount cannot be lower than the statutory minimum wage and cannot exceed the average net remuneration. Uninsured pregnant women whose average monthly gross income per family member is equal to or lower than BGN 450 (EUR 230) are entitled to a lump-sum allowance of BGN 150 (EUR 77) paid from government revenue.

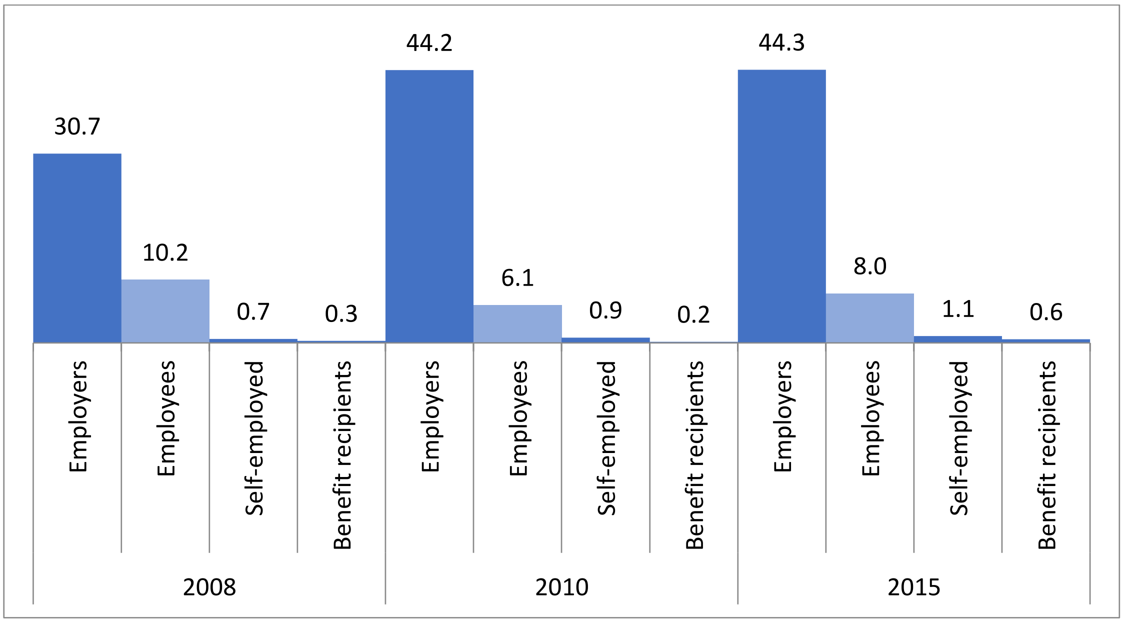
Figure 16. Division of financing of family and child benefits by main source, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

The bulk of social contributions for family allowances are covered by the employer.

Figure 17. Breakdown of the financing of family and child benefits by social contributions by sub-category, 2005-2015 (% of total financing)



Source: ESSPROS data by scheme, own calculations.

2.6 Housing allowances

Housing allowances exist as a legislative option and have always been fully covered by government revenue (general taxation) over the whole period 2005-2018, but the allocation rules are so restrictive, and actual receipt of such allowances is so rare, that from a macroeconomic expenditure perspective they can safely be ignored.

2.7 Social exclusion benefits

Social exclusion benefits have been fully covered by general taxation in the period 2005-2018. Social security benefits include two main schemes: monthly social benefits (monthly social assistance allowance) and heating allowance. Both are based on a differentiated minimum income, which is the guaranteed minimum income, multiplied by some factor: from 66% to 165% for monthly social benefits and from 167% to 311% for the heating allowance. In 2019, the GMI was BGN 70 (EUR 38). In some cases, the monthly social benefits can be reduced to 20% of GMI – e.g. as a punitive measure, if a child is not attending school.

The drivers for the increase in different types of expenditure on social transfers are different. For pensions – which constitute the largest expenditure – a specific indexation rule is in place which uses wages and prices in a 1:1 ratio (i.e. each year, pensions increase in line with the combined weighted average of gross wage increase and inflation); the weights currently used are equal, but they could in principle be calibrated, should the economic context require it. In 'typical' years, both wages and prices should rise, with wages rising faster. This means that in the long run replacement ratios and the purchasing power of pensions compared to wages should deteriorate somewhat. We can say that, in a way, several of the years since the beginning of this century have not been 'typical' – i.e. they appear as outliers, not matching the general long-term trend. The years before Bulgaria joined the EU were characterised by very high (ballooning) economic growth rates and unusually high inflation. Soon after Bulgaria joined the EU in 2008, the country started to feel the impact of the Great Recession. Wages stagnated (though not much and not for long), inflation was close to zero or negative (deflation) and the pension indexation rule was suspended for several years. Pensions are indexed yearly according to the increase in insurance income and the consumer price index (CPI) in the previous year. Between 2010 and 2012, pensions were not indexed due to the financial and economic crisis. There was partial compensation in 2013, when all pensions were indexed on average by 9.3%. Since 2014, pensions are again indexed using the same rule (2.7% in 2014 1.9% in 2015; 2.6% in 2016; and 2.4% in 2017 as of 1 July and a further increase only of the minimum pension from 1 October) (Zahariev, 2017).

We can say that – barring some major economic shock in the EU – the years from 2015 are probably more representative of what can be expected over the next 1-2 decades in Bulgaria in terms of public revenue and expenditure.

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

3.1 Distributive effects

A recent OECD study concludes that 'financing social insurance from general taxation revenue instead of social security contributions could raise labour market participation, reduce labour market dualism and boost growth, while at the same time extending welfare support to a larger fraction of society' (OECD, 2018). The Bulgarian mix of funding social security does not achieve the best **distributive effects**. In Bulgaria, the current rules in social security make social security contributions more regressive than personal income tax (PIT) – and even than indirect taxes. Social security contributions are proportional and have a cap. In this respect, the increased share of financing from general taxation can be taken to be a good development. In the period 2005-2016, total social contributions in Bulgaria measured as a proportion of GDP moved on a trajectory that resembled a U-shaped curve: first they decreased, driven primarily by policy reforms that aimed at reducing the tax wedge on labour costs; then they increased again, driven by a full policy reversal, i.e. raising the rates of social security contributions to avoid unmanageable deficits.

The current tax mix includes a very regressive PIT and a high marginal tax rate (MTR) on low earnings, which comes through the combined effects of the lack of any tax exemptions for low incomes and the restrictive eligibility criteria for social benefits (which practically exclude the possibility of preserving a portion of benefits after getting some income from work). **Since there is an obvious trend toward an increasing use of general taxation to fund social protection, one important challenge will be to make direct taxes more progressive. Such a measure will have a good distributional effect and will also provide additional revenue, despite fears that it might trigger increased tax avoidance. Social contributions can also be made more progressive by differentiating the rates according to the income or at least by significantly raising the cap on insurable income, or removing it altogether.**

3.2 Adaptability to demographic and social changes

Some components of the Bulgarian social protection mix – like old-age benefits – are currently well adapted to the demographic challenges of an ageing population. This has been achieved through a difficult reform of the pension system.

Bulgaria is among the EU Member States in which the increase in expenditure on pensions until 2070 is expected to remain within 1.3 pp of GDP – a modest increase, compared to most of the other EU Member States (Arevalo et al., 2018). In 2016, Bulgaria spent 9.6% of GDP on public pensions (lower than the EU average of 11.9%). From this perspective, the risk to sustainability of the pension schemes looks moderate.

The challenge remains to make the mandatory funded pillar (the second pillar) of the **pension system operational and sustainable**. Private pension funds until now have demonstrated unimpressive performance; combined with the high administrative costs, this has compelled the government to allow insured persons to switch between the private funded pension funds and public unfunded pension system. The impact of recent reforms allowing shifts between the funded and the unfunded system remains to be seen. Bulgaria has moved to a mixed funding of the unfunded mandatory pension pillar, and a return to a Bismarckian model is very unlikely. In 2016, Bulgaria was the EU Member State with the lowest implicit tax rate on labour (23.5%), which provides some room for policy manoeuvring (e.g. raising social insurance contributions) in case medium- or long-term projections about key factors influencing pension expenditure – such as fertility rates, migration, work intensity and life expectancy – prove inaccurate. It will require a substantial increase in the social security contributions paid by employers and employees, and will further increase the regressivity of the Bulgarian tax system. PIT in Bulgaria is proportional (flat), as are social security contributions, which however do also have a cap, though a relatively high one.

In Bulgaria, a tax shift to consumption taxation would hardly be feasible, because consumption taxes are already an important source of revenue. Bulgaria cannot afford further regressive distributional decisions, as it already has the highest inequality in the EU, as measured by the GINI coefficient and the ratio between the income of the top and the bottom quintiles.

However, the funding of healthcare remains a major challenge in terms of sustainability, and is very vulnerable to the ageing of the population.

Like the existing social insurance system, the funding of healthcare in Bulgaria was also designed as a contribution-based system. This design, which effectively excludes non-contributing persons and persons with arrears, has contributed to the loss of entitlements by many poor persons. It also faced a lot of challenges related to the transnational transferability of entitlements during the decades in which Bulgaria was a country of emigration (it still is). Recently the minister of health proposed a reform in the financing of healthcare that is modelled closely on the three-pillar pension model; but it did not generate much interest among politicians, the expert community or the general public.

Expenditure on healthcare currently seems the single most important risk to public social protection expenditure. The healthcare system has much inefficiency, and at the same time is a powerful generator of inequality. Bulgarian governments have so far not been successful at containing rising hospital costs or at enforcing a more rational geographical distribution of healthcare facilities through a National Healthcare Map. Very high private costs for healthcare – including out-of-pocket payments for medications and treatment – will require both reform and increased public expenditure. Health insurance coverage is not high, and the many attempts to increase it have not yielded the desired results. According to various estimates, there are about 900,000 persons without health insurance. The non-payment of health contributions (which results in exclusion from the system) is due to various reasons, most notably poverty, combined with unemployment, inactivity or work in the informal economy. The approach of the government to increasing the insurance rate has been based on the assumption that most people stop paying contributions due to opportunistic behaviour, whereas the main issue has to do with poverty. Consequently, the increase in punitive measures led to even more difficult access, and people were discouraged from re-entering the system. There is a need to establish a system of long-term care with clear funding mechanisms. Currently long-term care is funded under disability and overall healthcare functions. This is a source of inefficiency and service gaps.

There have been several unsuccessful attempts to introduce earmarked taxes on unhealthy foods, which could be an additional source of funding for healthcare.

Expenditure on pensions and on healthcare is strongly correlated in the long term. Life expectancy for both genders in Bulgaria (and some other countries that are lagging behind) is expected to increase by 11 years up to 2070, which indicates a process of catch-up with the rest of the EU. In 2070, Bulgaria is still expected to have the lowest life expectancy at the age of 65 both for males (21.5 years) and females (24.7 years), the difference between it and the leading countries being about 2.5-3 years for both genders (Arevalo et al, 2018). Pension expenditure projections for Bulgaria are very sensitive to changes in anticipated life expectancy. **Current trends in life expectancy in Bulgaria can indeed be significantly improved by investment in healthcare and the promotion of healthy lifestyles.**

Migration is also likely to exercise a pressure on pension expenditure, due to the outflow of the working-age population. Current migration trends projected into the future look realistic: they predict a continuing outflow, though at a decreasing rate. Negative net migration could be even smaller than projected. So we may consider expenditure risks related to migration as significantly mitigated. The current projections in Bulgaria are for an upward trend in fertility (an increase of 2.3 pp by 2070), which will make a positive contribution to the available work force and the projected hours worked in the economy.

3.3 Collectability and risk of evasion

Risk of evasion in the collection of social security contributions has decreased in recent years, but it remains high, as the informal economy is still quite large. Healthcare contributions are the worst affected: according to the Ministry of Finance, over the period 2010-2017 an estimated 700,000-850,000 persons did not pay health contributions[6] and did not have access to the healthcare package on offer in return for health contributions. However, the National Health Insurance Fund quotes a much larger figure (1.4 million persons), referring probably also to those Bulgarians who live abroad.[7] There are no detailed socio-economic profiles of those who remain outside the healthcare system, but some older studies show that about half of them are poor people, who cannot afford the contributions (Zahariev, 2008). The media have noticed that in the official statements by the Ministry of Finance for about 400,000 persons out of the total of 700,000-850,000, there is no explanation about the reasons for non-payment of the health contributions.[8]

The administrative costs of collection are not high. The National Revenue Agency is the single body responsible for collecting both social security and health contributions; it has administrative costs of about BGN 200 million (slightly less than EUR 100 million) per year. With these administrative costs, it collects revenue of about BGN 11 billion (EUR 5.5 billion) for old-age and health benefits, along with all the remaining revenue from other direct and indirect taxes, i.e. at a cost of EUR 1 (maximum) per EUR 55 collected. The full administrative cost of the overall management of the bulk of social transfers (beyond revenue collection) requires the budgets of at least two agencies to be added: the National Health Insurance Fund[9] and the National Social Security Institute.[10]

[6] Official reply of the minister of finance to a parliamentary question quoting an unpublished risk analysis by the Ministry of Finance from 2014, available at https://www.minfin.bg/bg/wreply/10627

[7] https://www.segabg.com/node/8039

[8] https://www.dnevnik.bg/bulgaria/2018/04/02/3157113_durjavata_ne_znae_zashto_blizo_400_hil_bulgari_sa_bez/

[9] Law on the Budget of NHIF 2018, available at https://www.nhif.bg/get_file?section=document&pageId=11203&uuid=62E68FCCEDC62CFAE05400144FFB42AE

[10] Law on the Budget of the State Social Security for 2018, available at https://nap.bg/document?id=15728

3.4 Labour market costs and work incentives

In the period before the global recession, there was a market trend towards reducing social security and health contributions, especially those related to pensions. During the global recession, this trend was reversed, as it became clear that the pension system was running into deep deficit. A plan for a gradual increase in the retirement age was also implemented. As a result of the reforms, the unfunded statutory pension system is now on track for long-term sustainability. Labour market costs have risen, but they do not represent a major work disincentive or a serious obstacle to doing business.

3.5 Vulnerability to structural changes in the labour market

The gig economy (on-demand economy) and gig jobs will represent an increasing challenge for the Bulgarian social protection system. There is already strong pressure from employers to make changes in legislation to facilitate on-demand short-term engagements. Employers have pushed forward ideas to extend the one-day contracts introduced in agriculture in 2015[11] to other sectors of the economy. Currently, such demands meet determined opposition from the trade unions, because they have the potential to erode trade unionism as it is organised today, and because – within the current social security framework – they provide further incentives for non-standard work arrangements, thus increasing social risks for the employees. In particular, trade unions have insisted that changes in the eligibility criteria for receiving social benefits are necessary for low-income workers on one-day contracts to keep their entitlements to social benefits (e.g. NTCC, 2015). Major restructuring of the economy and a shift to non-standard work arrangements could become the most significant challenge to the sustainability of the mandatory unfunded pension system, which is based on the PAYG[12] principle. In line with recommendations made by the OECD (2017) and the Annual Growth Survey 2018 (European Commission, 2017), it makes sense to **look for further opportunities for aligning benefit rules across different contractual arrangements** and **adapt existing social insurance schemes to extend them to previously excluded categories of workers**. It is important that the social protection system should play a flexible but neutral role, i.e. should react to changes in the labour market, without causing or reinforcing them.

To meet the outstanding challenges, Bulgaria will very likely look for innovations in the labour market inspired by the experiences (either experiments or established practices) primarily of other EU Member States, but sometimes of other countries (e.g. members of the European Economic Area). A recent example would include dual education (examples from Germany and Switzerland and direct support from the Bulgaria-Swiss cooperation programme); **proportional taxation** is an example of a policy introduced without direct influence from the EU (and especially without input from the countries of Western Europe, long considered reference models).

Since Bulgaria joined the EU in 2007, social security contributions for the self-employed have remained just 1 pp lower than the general contributions for employed persons. Since even before 2005 the system has experienced many reforms – some rather turbulent and unexpected – which means that the country will probably display resilience in case of further changes. **The complete alignment of social security contributions for the self-employed with mainstream social contributions will not be a major issue.** Several increases in all rates of social security contributions (for employees and the self-employed in parallel) have taken place since 2010, which were of similar size to (or larger than) the increase that would align social security contributions for the self-

[11] https://www.eurofound.europa.eu/sr/publications/article/2015/bulgaria-one-day-labour-contracts-introduced

[12] Pay-as-you-go, i.e. current contributions are used to pay current pensions.

employed with those for employees. Moreover, before it joined the EU, Bulgaria had a history of much higher social security contributions.

In Bulgaria, there is no serious discussion about a universal basic income; but such discussion is likely to arise – not least because such an idea has a chance of gaining support from both leftist and libertarian think tanks. Also, it appears to be of interest to the media and the general public. The Finnish experiment of introducing a universal basic income was widely reported in the Bulgarian media. News headlines presented the experiment as largely unsuccessful: the conclusions presented focused on the failure of the experiment to improve work incentives and to find any promising differences between those who received the guaranteed basic income and those who did not.

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