PROCEEDINGS OF THE
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SOCIAL SECURITY REFORM

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Chapter 1:

Problems and Experience of the Social Security Reforms

Experiences of social security reform in Bulgaria

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1. Description of the social security system in Bulgaria

The social security system (SSS) in Bulgaria is state-owned and based on the pay-as-you-go principle. It consists of two separate and independent funds - a Social Security Fund and an Unemployment Fund, and a system of social aid for low income groups, established at the Ministry of Labour and Social Aid.

The state Social Security Fund covers pensions, social payments in case of maternity and in case of a temporary fall in incomes due to illness, children allowances, subsidies for health-recreation and diet centres, payments for disabled people's equipment and home care. The contributions to the Social Security Fund (SSF) are of a total rate of 39% and are paid as follows: 37% of wage by the employer and 2% (introduced in 1996) by the employee with no explicit differentiation relative to the social security event it covers. For professional groups with an earlier than the average retirement age the contribution paid by the employer rises to 40% or 45%.

The contributions to the Unemployment Fund are 5% to the wage paid by the employer.

The average level of social security system contributions is 44% and creates the feeling of being too high - an incentive to avoid payments.

2. Financial gaps in the Social Security Fund

The regulations governing the functioning of the SSF underwent a series of changes after 1991.

The first problem appeared because of the development of the private sector and especially of the self-employed. It was necessary to split the overall contribution of 39% according to the different social security events that can be covered by the SSF. The rate of pension contribution for self-employed is fixed at 22%, 5% for labour hazards and 10% for loss of income due to temporary illness and other social risks. Pension contribution is mandatory while the insurance for the other social risks is voluntary. The share of people contributing for all social risks is 41% while 59% contribute only for pension.

The minimum insurance income base is the minimum wage for the country which is negotiated in the Tripartite Commission, composed of the representatives of the trade unions, the unions of the employers and the government.

The outcome of the change in regulations is the widespread insurance of self-employed on the basis of the minimum wage. A mismatch has appeared in the structure of the number of employees by sectors and their respective share in the contribution receipts of the SSF. In 1996 the employees in the private sector represented 43.5% of the total number of employees. The share of people contributing to the SSF and working in the private sector is 32% of the total number of contributors. The share of the contributions made by the private sector in the total value of contributions collected is 6%.

The second factor that destabilizes the SSF is the structure of the expenditures with pensions (83.4%) dominating.

The principles of individual pension determination related to the history of the respective individual wage evolution and the years of labour experience underwent many changes in the last five years. The imbalance between the current inflow of resources to the system and the promised payments, especially of pensions, urged the numerous changes in the principles of individual pension determination. Recently, the regulations relate the one year lagged average wage for the country to the years of labour experience and an individual coefficient which represents the relative wage (individual wage to the average wage for the country) earned by the pensioner in past three years selected by him. This regulation should change again at the end of 1997.

The third factor that will dominate the development of the social security system in Bulgaria is the fast changing demographic structure.

Ageing population is not the natural outcome of a declining birth rate and longer life expectancy but the consequence of a series of emigration waves following 1989. It is difficult to count the number of people that left the country after six unsuccessful years of transition but they have largely been in the age bracket of 20 to 30 and in numbers close to 600 - 800 thousands (7 - 10% of the population).

The ageing population means the change in the dependency ratio from a close to ideal 1.64 in 1996 to 1.27 in 2020. The replacement ratio deteriorates by 20% in 2020 compared to 1996 (1996 replacement ratio of 0.312).

3. How to solve the problem

The solutions to the social security system financial problems cover the elimination of the short-term pitfalls and the restructuring of the system in order to adapt to the challenging changes of the future. There is no space to increase the rate of contributions as even the existing rate creates strong distortions in the labour market.

Keeping in mind the strong inertia and open reluctance to changes, especially related to social security reforms, we outline a set of short-term measures which may help introduce a long-term restructuring of the system.

First. It is necessary to isolate the pension fund from the Social Security Fund and to shift insurance for all other events either to the state budget directly (children and family allowances, payment to women on maternity leave, aid to disabled people and the like) or to the health-care insurance fund (to be established) in case of a temporary loss of income due to illness, labour hazards, and the like.

Second. Increase the retirement age and the minimum number of years of labour experience necessary to become eligible for a pension. However, this measure will have a medium-term effect if the ageing of the population continues. But it may alleviate the financial burden of the shift to a fully funded pension system.

Third. Draw the details of a new pension system based on a fully-funded principle. The existing pay-as-you-go system has already matured and it can create only problems in the future.

In brief, we suggest a two-pillar pension system to be adopted in Bulgaria.

The first pillar should be managed by the government and should be based on the pay-as-you-go principle with defined contributions. We propose a contribution equal to 50% of the minimum wage paid by the employer. The first pillar will guarantee a pension equal to about 80% of the minimum wage for the country. The individual pension will depend on the total amount of contributions collected and the differentiation of pensions will be related to the years of contributing to the system.

The second pillar will consist of a mandatory individual contribution to a pension fund established on the fully-funded principle. The individual contribution will be of 10% with the insurance income base deviating within the range of one to eight minimum wages. The employee is responsible for paying the contribution but the employer may do it instead.

The details of the proposed new system are in a process of clarification. The transition from the now existing to the new system might be financed partially by increasing the retirement age and partially by financial assistance from the World Bank and other donors.

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