The public pension system's next step reform factors in Kyrgyz Republic

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Abstract: *This article reflects on the central issues of the pension system in the Kyrgyz Republic and the prerequisites for its modernization. Due to its scale, it seems impossible to reflect all aspects of activities in one study. At a time of political and financial turbulence in the world, the factors of specific socio-economic conditions, the need for a pension system sustainability, and financially sound principles of pension benefits provision become vitally actual. Due to its social significance, the issue of modernizing the pension system is widely discussed. All this makes it necessary to develop a social insurance members' centred approach to reforming the pension system, which affects the interests of citizens, employers and the state. The current research applies to the national pension system big data research using the ILO/PENSIONS platform in 2022-2023. The research created a strong potential for the platform to become one of the most effective actuarial tools globally.*

Keywords: Pension fund, social fund, social insurance, pension provision, material support, guarantee, solidarity system, accumulation system, income, length of service, differentiation.

Due to their social significance, pensions play an important role in the country's economic, social, and political life, as well as in the financial and budgetary spheres of the state.

The pension system is organically linked to the state of the labour market, tax and financial systems, demographic and socio-economic situation in the country as a whole.

In the structure of the population of the Kyrgyz Republic, retirees make up about 670 thousand people or 10% of the total population. According to the National Statistics Committee, the average life expectancies are 14 years for men and 21 years for women after conventional pensionable ages. So that, providing a decent pension amount is one of the most pressing issues for the modern Kyrgyz Republic.

In the late nineties of the last century, reforms replaced the unified, impersonal, and equalized soviet pensions with a comprehensive, personalized, and multi-level pension system based on social insurance. The new pension system considered the new economic relations that had been emerging in the country. This long-term program included a gradual transition to the new principles of pension provision while respecting the pension rights acquired in soviet period and addressing current challenges and strategic issues.

The state pension fund had to take measures to maintain the living standards of retirees in the face of rising prices, and what is more important the pension fund kept and strengthened state guarantees of the constitutional right of citizens to retire.

Since gaining independence, the Kyrgyz Republic has struggled to create a comprehensive legal framework for societal development and a fruitful economy. The reforms carried out over the years have helped to overcome the adverse effects of the transition period and laid the foundation for the transition to large-scale social reforms, the primary purpose of which is to improve the well-being of the population. Pensions were an essential component of public policy for social protection.

Through the years, reforms have created personalized and multi-pillar pension insurance, and provision is based on merit and acquired rights. Finally, the Kyrgyz old age social protection model comprises social assistance part, compulsory social insurance as defined benefits pillar, and pension savings as defined contributions pillar. The pension system inherited minimum subsistence and merit principles. Most pension sizes are equal to the minimum subsistence level.

Despite the fact that a social insurance system covers all categories of the active population, from a quarter to one-third of the pension fund is paid as a subvention from the central state budget. The rest is contributory. DB scheme is vulnerable and exposed to various risks. Both long-term demographic processes and medium-term macroeconomic figures directly impact the economic sustainability and effectiveness of the social protection system, the financial share of which has been growing over the last few years. Year by year, we observe that the mentioned state budget subvention and total pension expenditures in the GDP structure are rising. Hence, despite the growing economy, the public pension fund of a country is big in size in GDP, not stable, prone to political risks and requires continuous control. Moreover, the latest pension policy has hardly been defended by the government. In the opinion of local experts, the policy was not tuned well actuarially and, sooner or later, it will lead to the following risks:

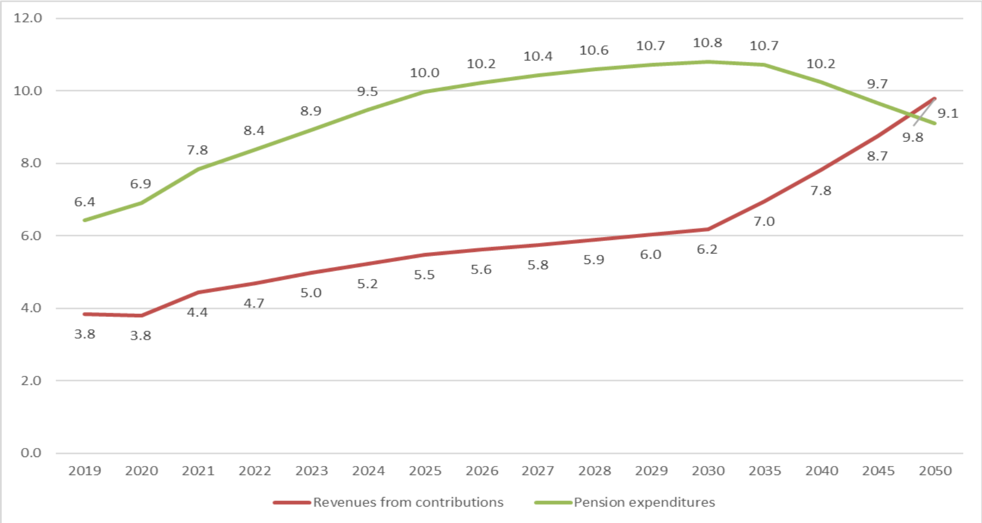
a) To create a deficit for the state budget in the middle run perspective, taking into consideration a significant size of subventions are being involved. In the post-communist history, the pension system of the Kyrgyz Republic experienced 6 months of arrears in pension payments in 1994-1997 due to a budget deficit;
b) Lack of pension contribution base and persistently high level of dependence rate on the working population. The situation deteriorated after 2015 when tax authorities became responsible for collecting social contributions.

All the considerations above lead to the understanding that the pension system's sustainability is a primary goal. This undoubtedly becomes even more relevant during the demographic crisis and in the context of a fully defined benefit system that pays pensions from a redistributive fund.

According to national statistics and statistics on pension assignments, the country is currently experiencing a demographic crisis and being affected by an ageing society.
In 2022-2023, actuarial research analysed the main indicators of old age security. We are paying attention to those researched indicators that are relevant to the problems we highlighted above. Specifically, we test the pension fund's sustainability by analysing the national pension system's general revenues and expenditures, dependency and contribution rates, and retirement age.

Pension fund sustainability. Nowadays, based on the norm in the pension law, the pension system is provided by subventions from the state budget, which is equal to up to 40 per cent of the total pension payments. Total pension expenses and their share in GDP rise every year. Pension expenditures have sharply increased in the past decade, from 2019 to 2030 (6.4 % in 2019 and 10.8 % in 2030). The trend keeps the value around 10-11% in GDP in 2030-2045 and then slowly decreases down to 9.1% in 2050.

Diagram 1. Pension parameters in GDP.



Source: (2505) NDC/InGDP

The scenario defines a financial deficit up to 2042. A significant rise in the deficit is expected in 2022 and 2033. The current negative surplus of 16B will rise to 30B in 2029. Due to the increment of the active population, starting from 2034, the balance will improve, and significant progress will be made in 2040 by showing a negative surplus for 13B. The model draws a positive surplus starting from 2042.

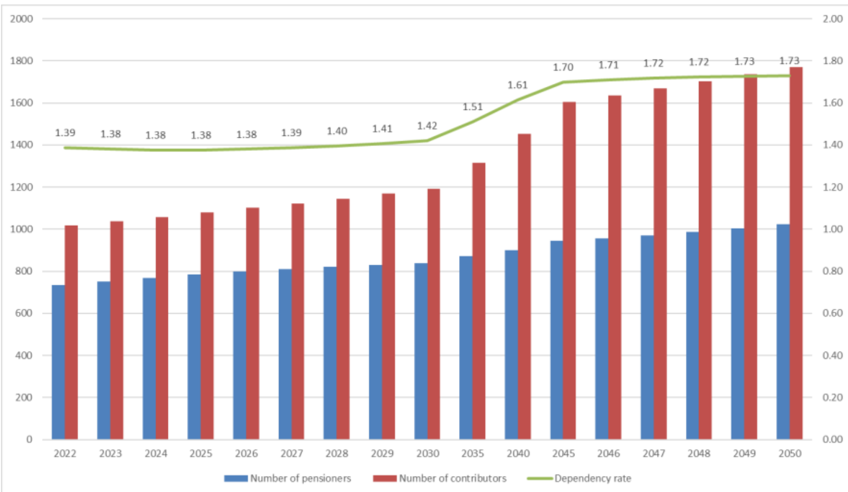
Diagram 2. The balance of revenue and expenditures.

Source: (2505) NDC/FinBalance

Even though in 2045-2050, the number of pensioners will start growing significantly because of the population ageing, in the early 2040s, a positive surplus in the pension budget is expected due to the rise of the active population within the main labour force age groups.

Dependency rates. The number of active people is increasing over the years, but even in the long term, the absolute dependency rate (ADR) will still be low and not exceed 2.0 (At 2050, the ADR will hardly be equal to 1.7 - 1.8). Participation in the social insurance system will be low for years and equal to 27 per cent of the total labour force.

Diagram 3. Dependency rate.



Source: Source: (2505) NDC/Dependency

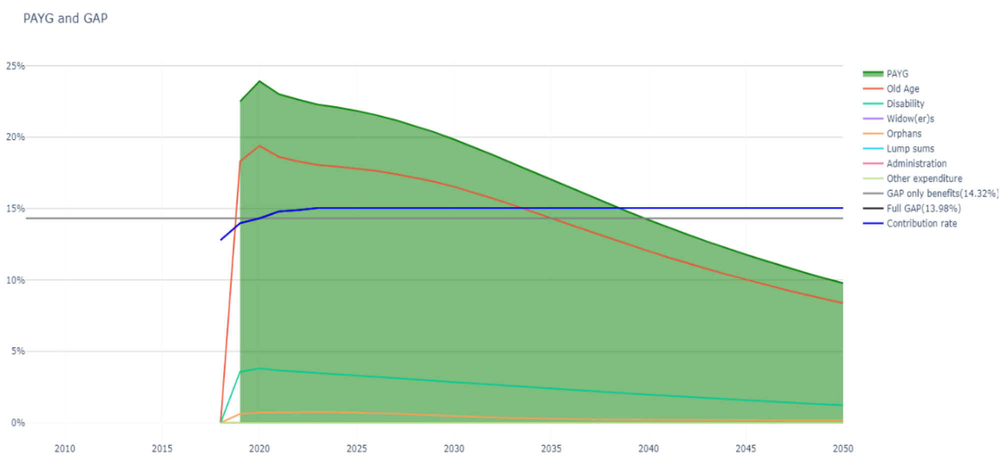
Consequently, the real dependency rate might remain at a low level. It makes the pension system vulnerable to the current and future challenges. In turn, the replacement rate remained low for men for old age pensioners at the level of 28-33 per cent, as well as for male disability 18-22 per cent. Women's old age pensions replacement rate stays at the level of 39-41 and accordingly 32-34 per cent for female disability. The rates show a significant decline for all pension risks for both genders. It might lead to a disbalance of pension system factors and low pensions. In order to avoid the disbalance, the public pension system should expand schemes and include a wider range of workers and industries. This inclusive approach ensures that no one is left aside, and the redistributive system will not be limited but extended. In this case,

An increase in the number of pensioners is expected along with the growth of the number of contributors in the national social insurance system. In the period of 2022 – 2028 and the next period stabilization of 2028-2030, there is a low period of absolute dependency rate at the level of around 1.38 – 1.43 as a dependency of pensioners on the number of contributors. The dependency rate will increase after 2030, approaching 1.61 in 2040, 1.70 in 2045, and 1.72 – 1.73 between 2045 and 2050.

As is obvious, the relative dependency rate is lower due to the low level of social contributions. Using the same proportion of the formal and other informal sectors in the projection, we may calculate that the relative dependency rate might be equal to 1:1, i.e., one contributor over one pensioner, which is the lowest value of the real dependency that impacts negatively on pension fund sustainability.

Contribution rate. The actuarial analysis shows that the average pension contribution or general average premium (GAP), which is 14.3 per cent nowadays, doesn't cover pension expenditures without subventions from the state budget. For the pension fund to be self-sufficient and sustainable, the average contribution rate should be at the GAP 22 per cent until 2035-2040. Otherwise, there is a risk of a negative surplus for another 10-15 years.

Diagram 4. Average level of social contributions.



Source: ILO/PENSIONS platform charts

The analysis shows that the pension fund is not sustainable today and still requires huge subventions from the state budget.

The model shows a further increase in the deficit, much more than the current level of subsidies. The baseline scenario calculates a significant negative surplus between incomes and expenditures within the national pension system in 2019-2050.

Retirement age. There is an inequity in the system since men retire at the age of 63, whereas the retirement age for women is 58. Statistics show that the average age of pensioners is growing, and the life expectancy of pensioners is becoming longer. On average, the life expectancy rises for 5 years in 2040 compared to 2022. Hence, it is recommended that gender inequality be eliminated by raising the retirement age for women. Techniques for increasing the retirement age might be different and contain mainly a gradual increase in the limit up to the age of 60 and more age. It provides a longer productive employment age for women.

Conclusions

The national pension system experiences an increasing number of pensioners and a worsening negative surplus between revenues and expenditures. The mentioned financial "worsening" period might be seminal unless the Government takes relevant measures to reduce early retirement, enlarge the scope of contributors, optimize contribution rates, and increase the required social insurance length for both men and women.

The Government should take measures in the short term, starting legal initiatives to eliminate state responsibility for basic pensions by gradually decreasing and eliminating state budget subventions to the pension fund.

Due to the policy of irrational contribution rates, the real dependency rate might remain at a low level. It makes a pension system vulnerable to current and future challenges and compromises its sustainability. For the moment, macroeconomic stability restored, fiscal consolidation was more robust than planned, monetary policy enhanced through a new interest rate-based framework, and supervision strengthened in the financial sector. The social insurance system should consider the Government's efforts and use economic growth to attract additional active population into the contributory pension scheme. Now, participation in the system starts at 50 per cent of all affiliated members, which is inappropriate. Moreover, several risks remain. The exceptional performance of gold output has not reached its stability due to uncertain managerial and associated expenditures, a slowdown in the Russian economy, declining gold prices, and uncertainty created by the recent fluctuations in the exchange rate, which could adversely affect those positive outcomes.

Another consideration relates to the pensionable age. The retirement ages increase for men and women and are regularly postponed due to political reasons. This is a key consideration for improving the pension system's sustainability and mitigating the risk of the ageing population.

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