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Public Pension Reforms: Challenges and Perspectives of Population Growth and Aging in Central Asia

Sherzod Rajabov
Senior Researcher, Tashkent Financial Institute
60 A, Amir Temur street, 100000, Tashkent, Uzbekistan
Tel: +998977474404; E-mail: robredos747@gmail.com

Abstract

Common features of all transition and developing economies are concentrated around pension reforms, transformations in supply public goods and services, fiscal optimization and cost-effective social protection due to the structurally supported diminishing role of public sector. In post-Soviet economies, public pension system is under radical transformations in parallel with economic transition. Although all former Soviet members have distinguishing pension system structures, the destination is common – transition of pension burden from public to private pension funds in a gradual way. Only in Central Asian economies pension reforms are going on a different path. This article reflects the finding of long-term research in public financial management studies the recent pension system development and analyses the efficiency and relevancy of taken measures in all five Central Asian countries in the context of rapid population growth and aging.

Keywords: Pension, Central Asia, demographic policy.

1.Introduction

Pension systems of all types are facing crucial and far-reaching challenges because of demographic trends, the continuing impacts of the economic crisis, and the environment of low growth, low returns and low yields (Antolín-Nicolás, 2015). Post crisis scenario for pension systems in developed and developing economies, especially in transition economies differ in terms of orientation, structure and coverage depending of funding sources, population dynamics and life expectancy. Crisis-led fiscal imbalances, unemployment growth and increase in number of low-income class posed a risk for public pension schemes, in the context of aging boom and longevity. In the global context, the most identifiable risk for pension is aging problems. Impact of population ageing on pension systems, both pay-as-you-go defined benefit pension and funded pension schemes is a significant challenge for economy in general and social protection at equal levels, no matter they are developed, developing or in transition. Pensions in developed economies are privately accumulated as a fund and can be invested in any priority sector. Income levels and retirement benefits have market-oriented character. The most challenging case is often encountered in transition economies who are decentralizing the absolute public ownership and high level of state intervention through privatization and liberalization. Their population is vulnerable to any changes in income sources and levels, as the communist mind of reliance for public financial support still exists and gradually eliminating as economic reforms go deeper. As a part of post-Soviet community, Central Asian countries have been facing series of problems in social protection reforms, including pensions. Therefore, most of them opted for the socially-oriented path in all reforms in transition period in order to prevent low-income class of population from emerging income inequality.

Admittedly, not all of Central Asian economies are able to cover all expenses with social protection packages, especially with retirement pensions. Roots of underfinancing come from improper demographic and family-support policy of former Soviet Union. In order to provide the labour supply in agricultural and heavy industry sectors, Soviet government supported fertility rate promotion programme and offered financial incentives for low-income population who gave a birth for more than 9-10 children. As a result, poor members of the union (Central Asian economies were seen as a burden for the Soviet budget) underwent a sudden explosion of fertility rate, although the extreme lack of daily needed goods and poor living conditions. After the dissolution of the USSR, newly independent states of Central Asia began reforming the pension system structure and imposed new levies and taxes to cover the pension expenditure. Supply chain crisis, high level of unemployment and economic downturn made public budget to adjust Soviet-inherited publicly funded PAYG to more modern and market-oriented pension schemes. However, implications of Soviet legacy – “ultra-prudent” demographic policy led to serious constraints in pension fund balance sheets: number of old people grew faster than population growth.

2. Effects of Aging in Public Pension in Central Asia

Aging populations are a global phenomenon with potentially significant consequences and repercussions for, among other things, health care, pensions, and old-age care—particularly so in Asia where populations are aging fast, because of declining fertility rates and increasing longevity (Handayani, 2012). At independence, all the countries of the former Soviet Union inherited an extensive system of social welfare, including a comprehensive pay-as-you-go (PAYG) pension system characterized by low retirement ages (60 for men and 55 for women) and relatively generous opportunities for early retirement for selected groups of workers such as miners, agricultural workers, members of the armed forces, ballerinas, and "hero mothers" among many others (Falkingham and Vlachantoni, 2012). It resulted in a hidden explosion of birth rate and consequent rapid population growth. Nowadays, population aging, decreasing mortality and increasing life expectancy are key future challenges for pension systems. Considering the dominance of PAYG structure in all five countries, it is anticipated that public pension schemes face serious sustainability problems in recent decades. Public pension funds are exposed to high level of longevity risk owing to mortality and revival of fertility rates (Figure 1 & 2).

Figure 1. Number of population in Central Asia in 1990-2014

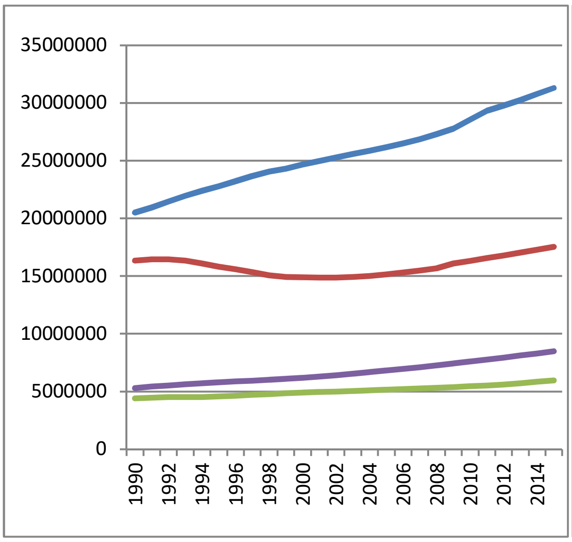
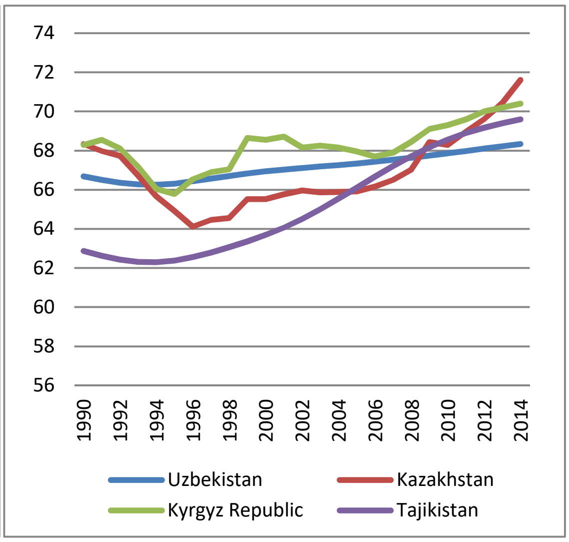


Figure 2. Life expectancy (both genders) in Central Asian countries in 1991-2014, years



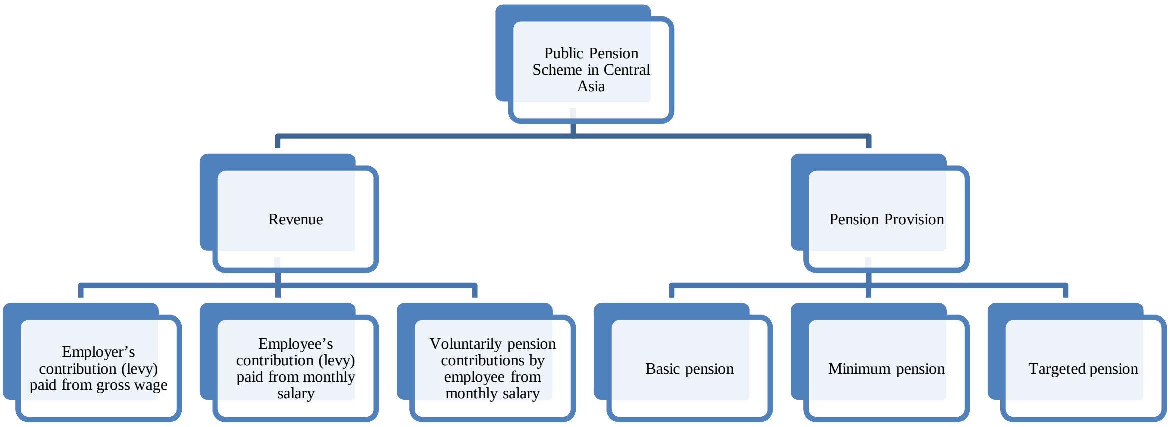
Source: Authors data compilations from official releases, 2016.

Population growth trends in Central Asian countries are different. In Uzbekistan, pre-independence and current number of population is about 12 million people or 59 per cent growth in 25 years. Demographic trends in Tajikistan and Kyrgyz Republic grew at a significant pace, but current and pre-independence difference does not exceed 15 per cent. Kazakhstan is the only country which experienced a decade of fall in number of population followed by a significant upward change. The most challenging case is of Uzbekistan whose population is more than total population of the other Central Asian states. Despite population growth, fertility rate in all states declined and growth rate decelerated.

3. Pension Reform in Central Asia: How It Responds to Aging

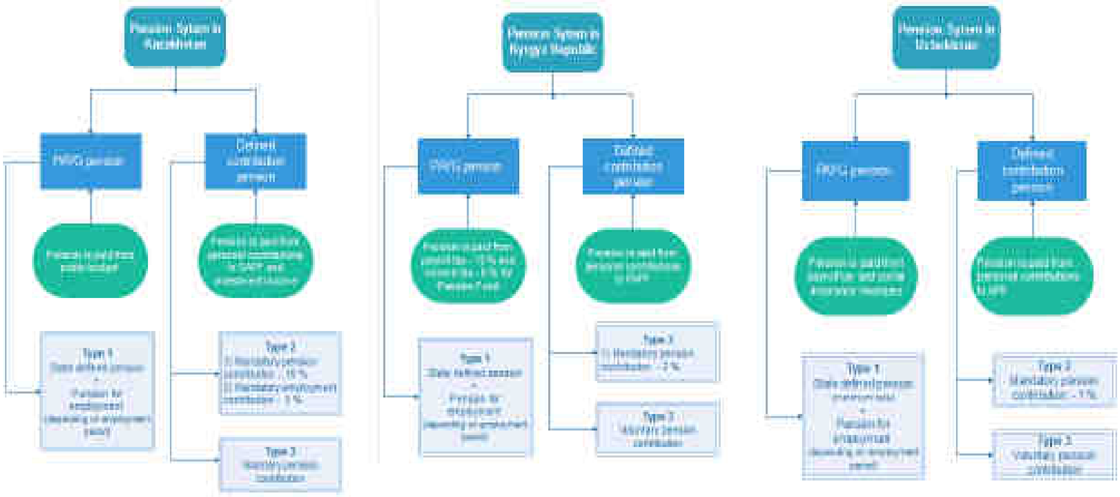
Soviet-inherited pensions systems was to generous to provide pensions for population. After collapse of the Soviet Union, member countries faced severe problems in funding pensions. In early independence period state owned enterprises were closed down, inflation and unemployment rose and informal sector developed. Consequently, tax revenues reduced several times, while low-income or poor class of population expanded in the same ratio. Generous social support scheme came to die, as newly established governments decided to cut social protection expenditures due to unsustainability reasons. Privatization could not give the expected results in promoting the employment, tax payments and pension revenues. Private companies began evading the tax system and pension payments with several hints, tax non-compliance and avoidance increased. In a short period, pension funds in Central Asian economies (who were poorest members of the Union) fell into deficits and pension payments went to months-long arrears. Moreover, hyperinflation evaded the value of pensions (1336 % in Uzbekistan, 3000 % in Kazakhstan in 1996) and number and life expectancy of population continued to increase.

Difficulties in pension funding made Central Asian countries to take step towards radical changes in pension system. It showed that it was the very time for cutting the base of generous PAYG and made changes to optimize pension provisions. The early step was put by Kyrgyz Republic in 1992 by cancelling all age-related pension privileges. Kazakhstan (1996) and Kyrgyz Republic (1997) introduced defined benefit pension as a partial alternative for PAYG to reform the public pension on gradual basis. Kyrgyz Republic shifted the pension eligibility age from 60 to 63 for men and from 55 to 58 years for women in 1997 and restructured the Soviet-inherited Pension Fund into Social Fund with equal status to a ministry in 2004. Uzbekistan established a separate Extra-Budgetary (Trust) Pension Fund in 2000 in order to reduce the impact of fiscal balance on public pension and introduced the practice after nearly a decade (2005) by establishing optional and mandatory accumulative personal pension savings accounts. Kazakhstan, Kyrgyz Republic and Uzbekistan adopted the Chilean reform path which is seen as a success story in pension history in the world. In 2016 Kazakhstan unified 11 private pension savings funds (established in 1998) into state regulated Single Accumulative Pension Fund in 2014. These three countries are moving from PAYG to fully funded, mandatory and personal based pension savings in line with pension provision and financing improvements as outlined below.



Aging and longevity risk is higher in all Central Asian economies who inherited an extravagant three-pillar pension system. Nowadays comparatively bigger dangers can be encountered in Uzbekistan among all other three economies. As many experts forecast, Uzbekistan will suffer from rapid growth and aging in future, if it does not reform the pension system further. Estimation of Yanchuk (2015) suggested that there are more than 700 thousand retired people who receive privileged pensions for their heroism (World War II, Chernobyl rescuers and Afghan war participants) or good performance at work. It made of 26 per cent of total age-related pensioners. Moreover, amount of pillars of pensions are sufficiently big to replace the monthly salary they received. Therefore, aging is a potential and existing risk for pension system in both short- and long-term, and it cannot respond to demographic changes in long run. Kazakhstan, Kyrgyz Republic and Tajikistan cancelled nearly all of pension privileges in early years of independence. Commonly remained pension privilege is for militants served in World War II (nowadays their number is rapidly decreasing). Aging risk is not serious for these three countries as for Uzbekistan, if population growth rate is considered. It shows that there is a doubled risk for Uzbekistan in pension provision. Amount of all pillars of pension in these countries is not high and replacement rate is also far from the amount of salary received in employment period. Kazakhstan and Kyrgyz Republic are gradually introducing a dual pension financing system funded by pension insurance and personal savings. It enables reduction of burden from public pension scheme.

Figure 4. Pension funding scheme in Kazakhstan, Kyrgyz Republic and Uzbekistan



Source: Rajabov, 2016.

Aging has a significant impact in pension system via labour market in Central Asia. Pension system in all Central Asian states allows pensioners to work and receive pensions after pension eligibility age. Even they are retired they receive both monthly salary and public pension. In some former Soviet member states working after retirements is prohibited, in some of them if pensioner decides to work after retirement, he/she must choose pension or half-salary.

4. Conclusion

Findings my long-lasted research in public pension (as a part of public finance) recognize aging as a major problem. Societies with dynamic population growth regularly take measures to mitigate aging risk. This risk has a greater impact area in Central Asia due to economic transition and rapid population growth. Although scenarios in all four (four countries out five are studied) differ in terms of demographic condition and pension finance structure, principles and reform path are common. Deriving from pre- and post-independence pension and demographic history, shifting the pension eligibility age is not the optimal solution in socially-oriented economies. Principles of income equality support and high social protection seem to be overlooked here, if pension privileges are cancelled or indexation of pension amount is frozen. Pensioners may suffer from growing income inequality and social exclusion. I propose following scientifically-rooted recommendations for smooth transition and mitigation of aging risk in public pension schemes:

1. Acceleration of transition to accumulative pension scheme is an optimal clue for mitigating the aging risk. Accumulative part of pension savings should be extended by increasing the tax rate for mandatory payment from salary.
2. Establishment of private pension funds is also an alternative for public pension funds. In the context of rapid population growth and rise of aged population, private pension funds lessen the risk of aging on public pension.
3. Considering social side-effects, piloting private pension in a particular geographic/administrative area (region or district) enables identify different hidden risk and external shocks.

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