Public Pension Reforms and Social Security Improvement in Uzbekistan

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Abstract

Uzbekistan has been conducting in-depth reforms in all areas of economic system in the process of transition to market economy by keeping the principles of socially-oriented market economy. In the context of social orientation, the government is reforming the pension system with wider focus on the optimization of public provisions. This article examines the public pension reforms, analyses their impact on welfare system and provides theoretically-rooted recommendations for further improvement.

Keywords: public pension, PAYG, pension reform, welfare, retirement income, Uzbekistan.

1. Introduction

The trade-off between welfare of future and current generations is one of the key issues in macroeconomic research (Necula and Radu, 2011). As made clear by the changes in life expectancy and fertility rates in the last decades, crucial macro-economic and demographic variables that determine the support to PAYG system are highly uncertain (Demange, 2009). In the context of dynamic population growth and systemic financial crises in the long-run has been making the fiscal structures weaker and quality of life more vulnerable to any external effect. As a response to potential or already existing fiscal constraints, governments rethink social protection policies and evaluate the efficiency and impact. Especially in old age pensions there are two different paths of restructuring all over the world. One path devises the decentralization of single pension system and establishment of private pension funds as an insurance of prosperous aging. Another path supports the improvement of the public pension schemes by regular adjustments and development-led reforms in order to ensure the guaranteed aging by public funding. In most economies with the dominance of public pension system, PAYG pension scheme embraces all social layers of population and serves as a common frame of old age social protection.

After the collapse of former Soviet Union, most member states went deep into crisis derived from absolute disruption of supply chain. Most individual economies suffered from extreme lack of main goods and services which were supplied by other member states due to monosectoral economic specialization. Emerged long-term economic crisis led to high unemployment rate, rapid inflation and sudden deterioration of life quality. Sudden growth of low-income and unemployed population lifted the risk of welfare crisis. Despite the economic downturn in early years of independence, Uzbekistan managed the optimization of social protection and welfare system through series of reforms and structural adjustments. Adoption of public and pension saving schemes, extension of pension types and coverage, transition to performance-based pension calculation method brought the expected target of welfare stance.

Public pension reforms significantly increased the coverage and pension wealth and changed the ratio of tax burden of both employers and employees in terms of pension contributions. Furthermore, individuals gained the opportunity of dual pension benefit along with public pension provision. Launching voluntary pension scheme and access for personal pension saving accounts created a room for social stability after retirement with stable pension benefits. This paper presents the latest reforms in public pension schemes in developed economies and examines the compatibility with Uzbekistan's reform agenda on comparative basis, evaluates the impact of reforms and proposes recommendations for further enhancement of social policy.

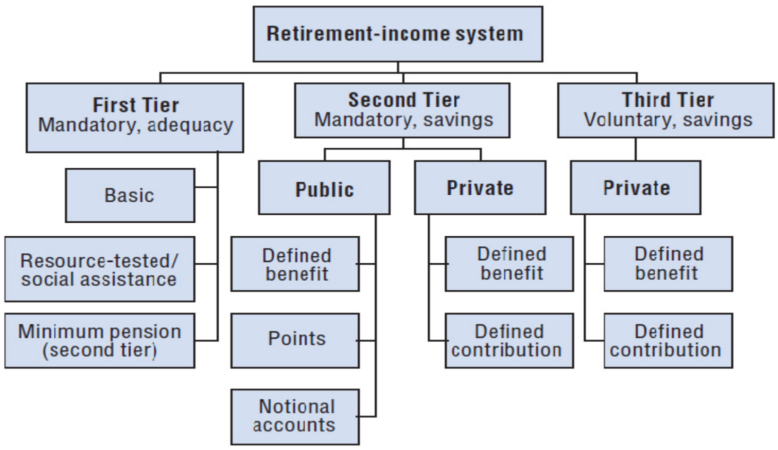
2. Literature Review

Public pension system in transition economies has been the hottest topic of academia debates around the world. Rapid changes in ownership status of enterprises, governance structure in public and private pension schemes, competitive and skills-based recruitment system, introduction of market force in labor market and developments in obtaining the retirement status are opening new areas of research and debate among academic rounds and policymakers. Impavido (2002) stated that policymakers and pension reformers are likely to be interested in addressing the design of pension schemes, governance issues, and performance as well as in improving the performance of public pension funds as part of their effort to instill financial and fiscal discipline throughout the economy, while academicians are likely to be interested in analyzing the aspects of governance in the private sector that are transferable to public schemes. The recent trends in studies on public pension schemes show the academicians' growing interest for investment opportunities of public pension funds and reserves, which is welcomed by policymakers at equal extent. Forman (2010) found that public pension plans have a significant impact on investment performance and funding status. Yermo (2008) evaluated the existing context as many countries around the world are partly prefunding their otherwise pay-as-you-go financed social security systems by establishing or further developing existing public pension reserve funds. However, other studies on public pension plans are concentrated on effects of public pension schemes in labor market, fiscal and social security in an economy at large. Costrell and Podgursky (2009) found that assets of public pension have a significant source for effect governments in times of market decline and decreasing revenue, and have significant labor market effects, influencing who enters public service and how long they remain employed. However, public pension reforms, their relevance and importance differentiate in economic system and its profile. Developed and emerging economies have wider opportunities of optimizing the public pension schemes through shrinking the private pension due to comparatively more income and economic development level. In developing and some transition economies, old age group of population has higher dependency ratio for public retirement income.

3. Public Pension Reforms at Long Run in International Practice

Retirement-income regimes are diverse and often involve a number of different programmes. Classifying pension systems and different retirement-income schemes is consequently difficult (OECD, 2015). However, in terms of ownership status, mode of governance and orientation, they are public and private. Century-backed reform period in global scope had created a matrix of public and private, basic, minimum and social assistance pensions which brought an optimized and tailored pension system for each economy (Figure 1). Recent trends of reforms prove that public pension schemes are the object of modification in many countries, including all economic groups: developed, developing and transition. Common case for all is to lift pension eligibility requirements, increase taxes and mandatory contribution rates, reduce coverage of public pensions and to expand the scope and share of private pension funds through transmission. Introduction of diversified or mixed forms of retirement income provisions and use of different funding structures are under the impact of global financial crisis (Figure 1).

Figure 1. Pension system taxonomy and illustrative matrix



Source: OECD, 2015

Despite the long-term implications of global financial crisis, most economies are recovering the pre-crisis profile of their public pension systems through comprehensive reforms. Improving financial sustainability and increasing pension adequacy are the main issues in the reform agendas in most of them. Public pension reforms for improvement of financial sustainability and retirement income adequacy are conducted under several tools of regulation and adjustments e.g. reduction of net pension benefits, change of coverage of pensions, indexation, higher taxes and contributions, increase of statutory retirement age, restriction for early retirement age, financial incentives to work longer, improvement of administrative efficiency. Pension benefit reduction is the most common path of reforms in many countries. Australia will tighten the public pension procedure and save the money for pensions through asset test of Age Pension programme from 2017. Spanish government approved the new scheme of initial public pension nomination which will be adjusted by gains of life expectancy in every five years from 2019. Indexation is also being more progressively spreading trend among both developed and developing economies. Finland reduced indexation of earnings-related pensions from 1 per cent to 0.4 per cent. France adjusted the calendar of indexation from April to October. Greece and Belgium froze the indexation, as Czech government decided to keep a lower level of indexation till 2015. Some countries imposed new taxes, increased existing ones or tightened the tax incentives for pension incomes in order to increase the funding level of public pensions. Finland imposed a six-per cent extra tax on pensions exceeding 45 000 Euros. Canadian government approved a plan of increasing the contribution rate from 9.9 per cent to 10.8 per cent in 2017 (Figure 2).

Figure 2. Basic statistics of public pension systems in developed economies, 2013

Countries	Pension fund assets, % of GDP	Public pension reserves, % of GDP	Gross pension replacement rate from public pension schemes, %	Mandatory pension contribution and social insurance contribution rates, %	Public and private spending on pension benefits, % of GDP
Australia	102,2	6,1	13,5	9,5	5,6
Austria	5,7	x	78,1	22,8	13,9
Belgium	5,0	5,1	46,6	16,4	11,4
Canada	70,8	17,2	32,6	9,9	7,6
Denmark	42,1	x	21,5	13,4	10,9
Finland	48,7	27,0	55,8	24,8	10,5
France	0,4	2,5	55,4	21,25	14,1
Germany	6,1	x	37,5	18,9	11,4
Greece	0,1	x	46,2	20,0	14,9
Iceland	141,2	x	3,4	19,8	5,9
Ireland	52,3	x	34,7	14,75	6,1
Israel	50,5	x	11,8	25,0	4,8
Italy	6,0	x	69,5	33	16,2
Japan	29,2	26,8	35,1	17,5	13,0
Korea	6,0	29,9	39,3	9,0	2,3
Netherlands	148,7	x	27,1	20,9	11,2
New Zealand	18,8	x	40,1	6,0	4,9
Norway	8,1	5,7	44,0	22,3	6,1
Portugal	8,9	6,9	73,8	20,2	13,6
Spain	8,8	5,1	82,1	28,3	10,5
Sweden	9,1	28,0	42,7	22,9	9,9
Switzerland	113,4	x	23,3	26,6	11,5
United Kingdom	99,6	x	29,7	20,95	10,2
United States	83,2	16,5	35,2	12,4	11,2

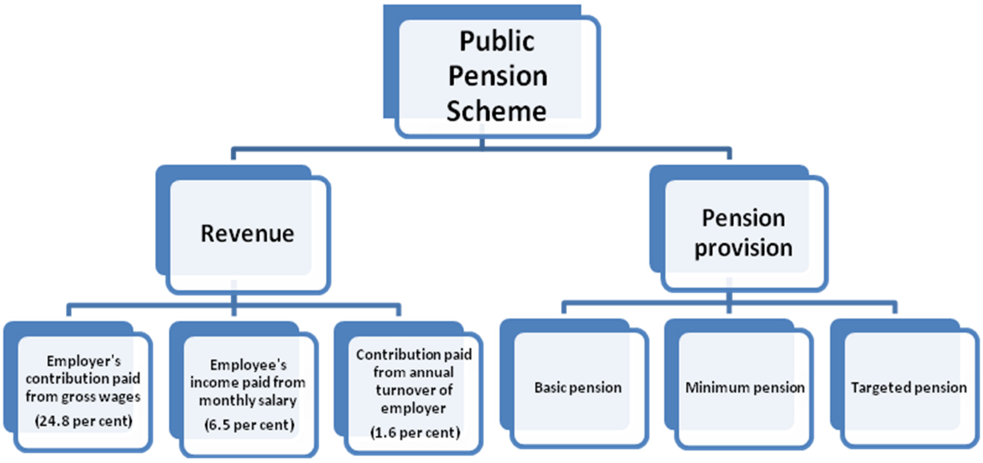
Source: Author's data compilations, 2015

The success of pension reforms depends on the effective implementation of action plans and keeping the momentum for further adjustments. There is no absolute positive impact guaranteed after reforms. Most economies are encouraging the pre-retirement population to work longer and are promising adequate retirement income through different tools of funding both public and private. Moreover, pension systems are at risk of aging population and growing life expectancy. According to UN's estimates, number of elderly people older than 65 increases from 8 per cent to 18 per cent till 2050. It will boost the public spending on the provision of retirement benefits for growing number and age of retired class.

4. Public Pension System Optimization in Uzbekistan: Reforms and Effectiveness

Pension system of Uzbekistan is in the stage of modernization and its structure, role and liability of subjects of legal relations, financial and organizational mechanisms are changing (Shamsuddinov, 2004). Uzbekistan is a new, but a progressively growing economy with high demographic growth and high level of skilled workforce adequacy. Recent and upward demographic changes and transition to market economy lead to the modernization and optimization of pension systems through flexibility tools of social protection and personal savings. Reform history of Uzbekistan is divided into two main steps which totally changed the existed condition: (1) establishment of the public trust Pension Fund and (2) launch of pension savings account on mandatory-low percentage and voluntarily basis. Establishment of the Pension Fund as a standalone trust fund from the public budget was a comprehensive positively driven measure for ensuring a stabile and permanent retirement income. Launch of individual pension saving accounts gave an opportunity to accumulate money for higher retirement income on voluntarily basis and mandatory fixed contribution of 1 per cent of monthly salary. After development-led reforms in social protection policy, Uzbekistan's pension system gained the all three types of pensions as in international best practices: basic, minimum and targeted. (Figure 3). In line with adoption of globally recognized and self-proven structures, achieved results of pension system reforms shows the increasing adequacy and coverage of pension income.

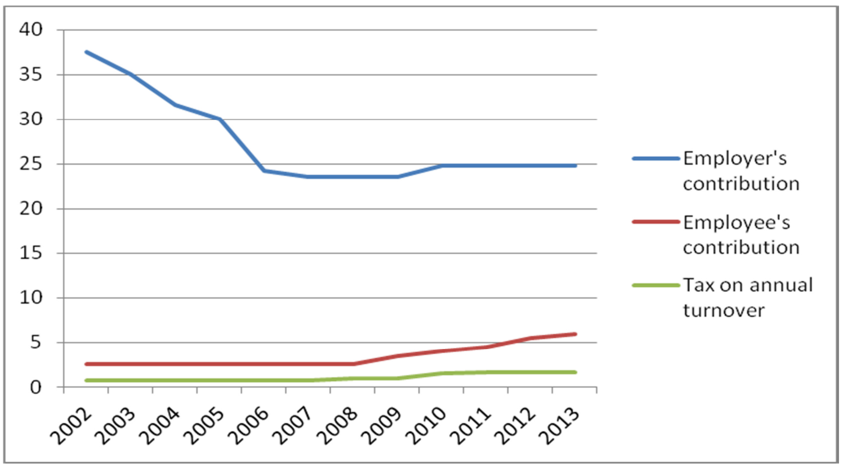
Figure 3. Post-reform structure of public pension scheme in Uzbekistan



Source: Author's compilation

Pension system optimization actions have been conducted on gradual basis since the early years of independence. Application of Soviet-inherited pension structure, which relied on PAYG system, showed that further application of that structure is incompatible with large scale economic reforms. In former Soviet period employer was only public sector and private or corporate structures were strictly prohibited. New ownership and business structures required the immediate changes in employee's pension accumulation procedures. Uzbekistan adopted new payroll tax structures which if levied on three different tax bases: employer's paid gross monthly wage, employee's monthly salary and levy on employer's annual turnover. From another side, pension wealth accumulation opportunities enlarged with introduction of personal pension saving accounts, which government exempted personal pension savings from payroll and other income taxes, when it was paid from received monthly salaries. For business sector stability and support purposes, government reduced the PAYG tax burden for both public and private sector enterprises. Payroll taxes of individuals increased at the lower level of social indexation in order to keep their incomes permanent (Figure 4).

Figure 4. Public pension revenue composition from payroll and PAYG taxes in 2002-2013, %



Source: Author's compilations, 2015

As Figure 4 illustrates, public pension reform in Uzbekistan is balance-oriented and targeted to stimulate the private sector, especially newly established and low-profit operating enterprises. Absolute burden of mandatory pension contribution is stepping towards the most favorable ratio between employers and employees.

5. Conclusions and Recommendations

This paper reviewed the best practices and latest reforms around the planet, assessed the pace and efficiency of pension reforms in Uzbekistan. Both quantitative and qualitative analyses show that current international practices, mainly in developed countries, are conducted under the pressures of global financial crisis and its implications. As explained above, in most of them reforms are only for keeping the fiscal system stable, not the social security of population. Offering alternative retirement income sources are not always relevant and can match the needs and willing of the both working and retired people. However, in Uzbekistan's context, public pension reforms are truly socially-oriented and serving successfully for ensuring a favorable social security. In order to keep pace with developments in international environment and to stay sound, further reform actions are of considerable importance in condition of rapid population growth and increase in life expectancy from fiscal point of view. Lifting the pension eligibility age and higher requirements for work experience, slower or non-indexation are main measures which are commonly used in many economies. Considering transition process in Uzbekistan, tariff policy for pensions, and regulation of employment in formal and non-formal sectors, regulation of salaries and pensions of working retired people are the main issues to be reviewed by legislative standpoint.

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