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Pension Reform in Central Asian Transition Economies: Social Protection Stability in Uzbekistan and Kazakhstan

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Abstract
Social protection policy in transition economies are vulnerable to any fiscal risks rooted from implications of structural changes in public policies and long term strategies. Developing economic profile with rapidly growing and ageing population requires decentralized and diversified hierarchy of pension system in most post-soviet transition economies. In Central Asian case, pension system transformation strategies have been implemented in different ways and principles but for the unique aim. This paper examines the comparative and countercrisis analysis of pension reform frameworks of selected Central Asian economies.

1. Introduction

During the last three decades, social protection policies have undergone significant transformations and changes in both developing and transition economies with different magnitude and scope (Mares and Carnes, 2009). Social policy reforms have been a hot socio-economic issue in post-soviet transition economies which awaits the solution for many years, even decades. High level of exposure to external economic shocks, dependency for imported goods and services, tight budget and agrarian orientation led to a deeply rooted economic downturn in early 1990s. Supply chain crisis, fiscal instability, growing inflation and unemployment rate deteriorated the life quality in Central Asian states further. All post-communist economies launched economic modernization and fiscal optimization programs.

In a common scenario, fiscal reforms in transition economies are mainly concentrated on bridging the budget gap by reducing public expenses on social schemes and increasing tax rates or types. Most policymakers and scholars often argue that social sector expenditure optimization may lead to life quality deterioration in a changing environment of a transition economy, while the other scientists believe that privatization and social sphere optimization serves as a way of coordinated welfare regime, market orientation and liberalization (Kitzchelt et al. 1999). In Central Asia two states – Kazakhstan and Uzbekistan are restructuring their pension systems based on the experience of advanced economies. These two countries selected two different ways of pension funding for a unique goal – enhancing the quality of population and funding the government needs in transition process to market economy.

2. Literature review

Pension system modernization issues in post-communist countries have been discussed among policy makers and academic rounds since late 1990s. The early winds of research on cost optimization for social protection blew from Eastern European researchers who investigated the fiscal stabilization opportunities through cutting the expenditures in "strategically less important sectors" – education, healthcare and social protection (Mares and Carnes, 2009) and boosting the market oriented economic reforms (Brooks, 2002). Decentralization of PAYG system and adoption of properties of private pension schemes were more fiscally sustainable and supportive for macroeconomic growth, most soviet era scientists sanctioned the shifts towards efficiency-oriented market based social security system (Edwards, 1995). Multi-pillar architecture of modern pension system shows different effects in Eastern European and Central Asian countries who imitated the Chilean pension reforms (Antiparmakov, 2011). In early 2000s pension system reforms in both selected Central Asian states were welcomed by local and international academic rounds and expert groups. Removing the costly PAYG system which had negative fiscal implications, low worker to pensioner ratio, high level of pension arrears enabled the selected economies to support economic growth and capital market development (Andrews, 2001). In these multistage reform processes, experts began analysing the efficiency and quality, results and expectations, and proposing different scientific models and alternatives for government's decision (Saitenova and Becker, 2004).

3. Historical overview

In planned economy, pension system was an integral component of the state social security, which covers not only pensions and benefits, but also the various forms of social services, medical care of disabled and elderly people. Pensions were financed from tax revenues of state budget which inherited high poverty rates to newly independent Central Asian states in late 1980s and early 1990s. Even though social protection was fully guaranteed and provided by the government, poverty rate averaged at 38 per cent in Central Asia in 1989 (Pomfret, 2001). The current state of the pension system in both selected economies can be described as Pay-As-

You-Go system with elements of defined contribution pension. Kazakhstan was the first country among ex-Soviet states by introducing defined contribution policy and private pension funds in 1998 and founded several private pension funds. The government supported them and offered investment facilities to increase the contribution of pension fund investments in economic growth and national savings. Although pension fund capital brought significant economic outcomes, the government unified all private pension funds under Single Accumulative Pension Fund (SAPF) in 2014. Uzbekistan began pension reforms with public expenditure optimization framework. Later public pension provision system was reorganized under Extra-Budgetary Pension Fund (EBPF) of the Ministry of Finance in 2000 and Accumulative Pension Fund (APF) in 2005 whose all assets are under the control of the State Commercial People's Bank for social security purposes which highlighted in socially-oriented transition strategy to market economy.

4. 1 Current pension reforms and economic modernization

In condition of economic modernization, deepening of economic reforms and advances in social security require the enhancement of pension funding schemes. In socially oriented market economies social protection schemes are structured around subsidiary basis which concentrated on accumulation of contributory payments for future retirement pensions. If accumulated amount does not meet the minimum level of required volume, public budget allocates necessary amount in order to keep the life quality of beneficiary after retirement. From Central Asian view, all member states ensure social protection mainly from PAYG schemes. Funded pension plans and private pension funds have been evaluated as "novice to introduce but supportive if available". Because all Central Asian countries need external funding sources for economic diversification and modernization which can be achieved by creating favourable business climate, financial market development and free economic activity growth.

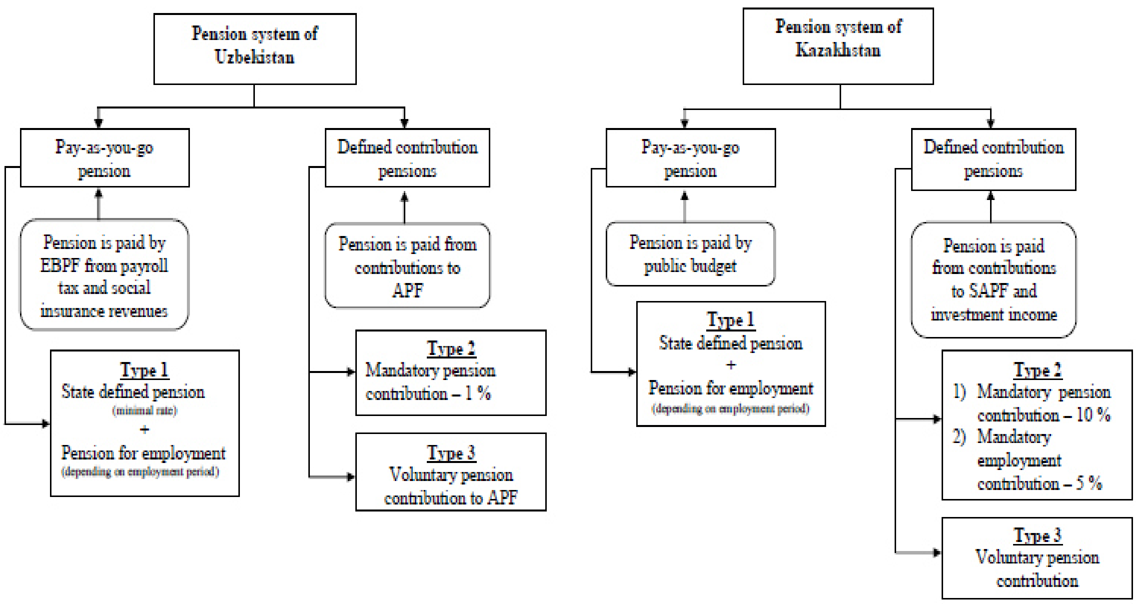
Kazakh pension reform was initiated to support economic growth in the country. Lack of investment capital and poor economic condition in late 1990s made the government find new sources for reviving the sinking economy. Uzbekistan put the steps towards pension reform in order to optimize fiscal and monetary profile and to mitigate the risk of sudden budget deficit. Gradual reforms were taken in consistent with economic transition policy. Current pension system of both countries is the same in structure, but different in terms of mode of state intervention and ownership. Both economies chose three-pillar combined pension provision system (Illustration 1):

Pillar 1 – A mandatory, publicly managed, tax financed first pillar pension redistribution - minimum pension guarantee PAYG system in Kazakhstan and employment period based PAYG system in Uzbekistan.

Pillar 2 – A mandatory, privately (Kazakhstan) or publicly (Uzbekistan) managed second pillar for pension savings – state mandated fully funded (Kazakhstan) and state mandated partly funded (Uzbekistan) defined contribution pension.

Pillar 3 – A voluntarily, third pillar for people who want more protection in their old age

Illustration 1. Pension system structure in Uzbekistan and Kazakhstan



Source: Author's compilation based on official releases of APF and SAPF, 2015

After decentralization of publicly managed pension assets, Kazakhstan and Uzbekistan introduced the three parallel pensions: PAYG, mandatory and voluntary pension contribution schemes. However, in terms of state intervention and ownership, pension systems differ: PAYG tax rate is 11 per cent in Kazakhstan, and 24,8 per cent in Uzbekistan (OECD, 2012).

As governments transferred their role to regulatory and supervisory action over pension system stability, three-pillar pension system structure brought the following aspects of international practice:

- compulsory pension scheme assets are accumulated frommandatorydefined contributions
- amount of pensionisproportionalto total amount and duration of contributions
- regular pension system stability and efficiency control
- compulsory replacement which guarantees the minimum amount of pension;
- amount of pension isincreased with individual contributions;

Alternating public pension provisions and privatization of pensions are seen as a universalistic social protection policy. Unsound economic profile and transition related changes are not the only factors which made the Central Asian states reform the entire social security system. Demographic factors influence on capital flows in both public and private sectors of economy in an equal extent. Population growth and aging are the major concerns in PAYG and defined contribution pension systems (Boursch-Supan et al., 2005). Therefore, high unemployment rate, early retirement and progressive aging obscure the effective functioning of PAYG system. These factors are deteriorating the capability of some Central Asian governments in ensuring a stable social protection and keeping the social protection index in a normal level (Table 1).

Table 1. Social protection index in Central Asian states in 2009

Country	Social Protection Index	Social Insurance Index	Social Assistance Index
Kazakhstan	0.156	0.12	0.03
Kyrgyz Republic	0.211	0.13	0.08
Tajikistan	0.021	0.01	0.01
Uzbekistan	0.235	0.17	0.06

Source: Asian Development Bank, 2011

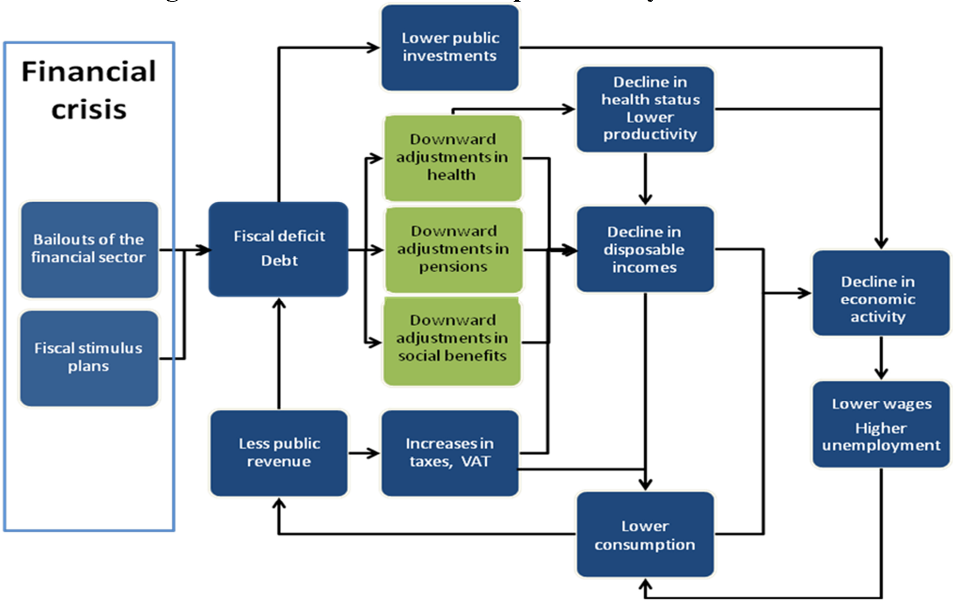
4.2 Pension system performance of Uzbekistan and Kazakhstan in global financial crisis

Global financial crisis sparked the importance and relevance of further steps in pension system improvement strategies of transition economies that were forming an effective and modern national social protection system in line with perfect social insurance systems. Sudden fall in the volume of public budget revenues, growth in employment rate and disposable income of population widened the fiscal gap in all transition economies (Illustration 2). Kazakhstan (-2.1 per cent), Kyrgyzstan (-1.5 per cent) and Tajikistan (-7.64 per cent) experienced significant shortfalls in funding the social protection provision and other public services.Kazakhstan launched a countercrisis program in order to in order to prevent the expansion of existing fiscal gap, falling export volume and foreign capital outflow. Among all transition economies of the planet, only Uzbekistan could keep the budget surplus (1.45 per cent) without any extra tax burdens, mandatory payments and wage reductions and job cuts. Social indexation was kept at 1.2 and annual average public pension growth reached 20.4 per cent in 2009.

The driving reasons for pension system transformation root from recent global financial crisis, which showed the following weaknesses and vulnerabilities in existing structure of both economies:

- Deterioration in social protection due to low revenues to public budget – mainly PAYG system suffered;
- Increase in unemployment rate – PAYG and defined contribution scheme suffered equally;
- Bankruptcy or temporary closedowns in exporting companies due to low demand in importers
- Low profit margins in pension fund investments due to market disorder
- Sudden increase in number of beneficiaries because of low income in crisis condition
- Comparatively lower profit margin of pension fund capital investments;
- Restriction for pension funds in access to financial markets

Illustration 2. Effect of global financial crisis in social protection system of transition economies



Source: International Labor Organization, 2013

5. Conclusion and recommendations

Pension system of transition economies should be regularly monitored and adapted to any significant changes in economic system. In this changing environment, governments are recommended to transform the pension provision in short term and long term, based on the gained experience from early transition period in 1990s and lessons from recent global financial crisis. In short term, both Central Asian economies are recommended to take following three important measures:

- Excluding the inflation rate in pension indexation;
- Revising the retirement age policy and shifting the age ceilings;
- Restricting the early retirement opportunities;

Short term issues do not require major revisions in long term pension system development strategies. Provided recommendations are expected to be key actions in long term pension system reform policies of transition economies:

- Ensuring the efficiency of financial risk mitigation in capital accumulation and retirement benefits;
- Liberalization of pension funds' investment activities;
- Launching financial market development framework for inflation-free pension fund stocks.

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