

## Pension Reform in the Republic of Kazakhstan: Main Directions, Conditions for Implementation and Development Prospects

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### ABSTRACT

The background of this study lies in the fact that since 1998 Kazakhstan started the pension reform which continues at the present stage. In this connection it is important to understand the essence of institutional pension reform, to determine current principles of pension and immediate prospects for development of this institution. The authors try to identify a theory or model that most adequately assess the recent changes in the pension system and predicts future direction of evolution of the social process. The chronological scope of the study covers the period from 1998 to 2016. The paper is structured in the following areas: isolated and studied the main directions of the pension reform; defined areas for further development of the institution of pensions. Methodological framework of the study is, first of all, theoretical position of general scientific systematization of complex processes (in this case, social), as well as the idea of interconnectedness and interdependence of social, economic, legal and other factors that determine development of the pension system. General scientific principles used by the authors in this paper include such methods as analysis and synthesis, induction and deduction, structural, historical and logical methods. The following main results should be emphasized: the authors have developed classification of the causes and conditions of the pension reform start; defined the concept of pension system development mechanism; prospects of the pension system development. The practical significance of the study is that its findings can be used for further exploring of the social processes which take place in Kazakhstan. The materials of the study can be used in educational process (in general and special courses for lawyers, economists) and also in writing of textbooks and monographs.

### KEYWORDS

Pension, pension system, the retirement age, budgetary provision, social reforms

### ARTICLE HISTORY

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### Introduction

In the second half of the 90s of the last century society in the Republic of Kazakhstan has been put before the need along with the ongoing economic reforms to start implementation social reforms which would reflect fully status

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and capabilities of budget funding for social security and does not infringe constitutional rights of citizens for warranty on social security provision. Objective reasons of changes in this area have become a series of preconditions that can be reduced to the following provisions. Firstly, unfavourable demographic situation developing in society and consisting in the fact that a percentage of the number of retirement age population relative to the working age citizens who pay taxes on economic activity has grown steadily, and this demographic situation of groups to each other is assumed to persist for a quite a long time due to a slight increase in population, natural processes of migration, etc. Thus, the number of persons of retirement age respectively to persons of working age is growing. Another reason was due to reduction of working population in the country which is economically active and is a direct group of persons who fund state budget by means of taxes payments

Officially registered number of unemployed citizens in Kazakhstan was not more than 5 percent relatively to the economically active population. However, the experts suggested that this figure must be multiplied by five in order to get a more realistic picture of unemployment in the country. A small number of persons registered as unemployed could be explained by the lack of incentives for people to undergo this procedure. It can be explained by the fact that financial assistance as the main stimulus was not implemented, and unemployment benefits have been cancelled in 1999. Thus, by the end of the 90s of the last century there was a situation in the state of disproportionate ratio in the society of working-age persons and those who are obliged to maintain them in accordance with the social public contract (working population).

The other reason for pension reform is the lack of mechanisms for the use of the Pension Fund for public service, their investment in the real economy, although in fact the money supply accumulated in the pension fund by 1998, equal to the amount of resources available to the state budget. However, as practice shows, this problem has not been resolved, and subsequently on the means of accumulative pension funds are not effective ones. However, as practice shows, this problem has not been solved, and subsequently on the means of accumulative pension funds, have not been found effective financial instruments for investment in country's economy.

In general, it should be noted that the practice of social reform in our country and in particular in the field of social security was due to a shortage, lack of funds to ensure the level of social security, guaranteed by law, and the main cause of the pension reform was due namely that provision. In addition, the pension system which operated contrary to market principles to ensure its level of contribution to the system. The absence of personal account of employees' pension contributions did not provide incentives to increase contributions and accumulation of funds on citizens' personal accounts. Besides, there was no monitoring of the employers' contributions.

These problems of funded and solidary pension schemes functioning were systemic in nature and demanded that the Government of the Republic of Kazakhstan taking drastic measures to reform the pension system of Kazakhstan in conditions of acute financial and economic crisis that accompanied the early years of independence.

While conducting the study the authors relied on the theoretical conclusions about the pension system set in the works of J. Myles & P. Pierson (2001), R. Disney (2000) and other researchers.

An analysis of modernization, embracing the social processes in our country, was carried out in previously published papers some authors of this article (Buribayev et al., 2015; Khamzin et al., 2016). Assessment of economic crisis effects on pension schemes is described by B.H. Casey (2012). Some matters of different models of pension reform effectiveness are disclosed in papers by P. Bridgen and T. Meyer, B. Paul & B.B. Riedmüller (2007), P.R. Orszag & J.E. Stiglitz (1999) and other scientists. Social aspects of the institutional construction of the pension system, implementation of social and pension forms of population protection in some countries were analyzed by G. Hughes & J. Stewart (2011), A.S. Orloff (1993), A. Chlon, M. Góra & M. Rutkowski (1999), D. Franco (2002), M. Regini (1997), M. Seeleib-Kaiser (2002), M.I. Vail (1999), R.K. Weaver (1986). Theoretical and applied analysis of foreign experience in the construction of the pension systems and their reform processes is represented in the works of M. Feldstein & H. Siebert (2009), K. Hinrichs (2000), L. Willmore (2007).

Kazakh system of pension reform was based on the implementation Chilean experience of Chile, therefore a special interest in conducting of this paper led to the study of works in evaluating effectiveness of the Chilean pension system, described in by R. Holzmann (1997), K. Weyland (2005), S. Edwards (1998), A.A. de Mesa & C. Mesa-Lago (2006). Methodological, economic and legal features of pension provision system functioning in the conditions of reforms are regarded in the studies by G. Bonoli (2000), A. Lindbeck & M. Persson (2003), G. Bonoli & T. Shinkawa (2006).

Despite the fact that during the last decade research interest in the pension system functioning increased, a comprehensive review of the social and economic effects of the pension reform, categorical analysis of the changes occurred, the problems of reforms in the field of pensions efficiency was not carried out. Despite the large number of studies on the problems of pension and labor motivation, development of pension institutions in independent Kazakhstan are still poorly understood, although their relevance is unquestionable. The present study, its theoretical and methodical positions and recommendations are intended to fill this gap to some extent.

## Methods

The methodological basis of the study was the modern theory of the organization of social protection and pension provision. Depending on the goals and objectives at different stages of research to identify the essence of the studied relationships and processes there were used categorical, systemic, structural and functional methods. The methodological basis of the work amounted general scientific dialectical method of cognition, universal scientific method (formal-logical methods of system analysis, synthesis), as well as special legal methods (comparative legal, formal or technical and legal, comparative historical). The issues of the pension system qualitative improvement and updating mechanisms of formation, registration and implementation of the citizens' pension rights were studied in four aspects: social and psychological (in the context of national priorities and cultural traditions), social and political



(including public administration features), economic (in accordance with the objectives for the growing material welfare of the population), legal (from the perspective of the analysis of legal support of the ongoing pension reforms).

## Results

Modern pension system of the Republic of Kazakhstan is a combination of shared and funded systems. They differ in order of formation and funding of pension benefits, conditions for occurrence of right for a pension, subjective composition of the participants. Combination of two different systems in the principles of their construction in Kazakhstan is a strategic line of pension service development. The state guarantees under the Constitution a minimum level of pensions regardless of ensuring it system. Introduction of the funded pension system was primarily due to objective reasons of economic nature that took place in society. The basic premise was the need to correlate the level of pension payments with the citizens' income. This main goal was not reached because the maximum annual amount of pension from the Common accumulative pension fund is a fixed amount for everybody, and it cannot exceed a certain figure.

Secondly, introduction into public consciousness the statement that everyone is responsible for their future pension and its level which, on its turn, should have solved to a certain extent the problem of unemployment and no less acute problem of hiding their real income citizens, workers and entrepreneurs. However, in fact, funded pension system does not solve any these problems. On the contrary, due to the confidence of citizens to the accumulative pension system, there occurs under-conscious of the earnings by citizens. In addition, there was not reached and no less important objective of the introduction of a funded system – pension savings management aiming to strengthen the country's financial market in order to collect financial resources for long-term social projects. The accumulated funds were used inefficiently. Funds faced the problem of investment in appropriate financial tools covering at least inflation by investment income. The main problem of accumulative pension funds remained the matter of the citizens' non-confidence, lack of belief in a decent future pension benefits that are basically the lack of effective legislation of the state guarantees in the area of pension savings safety. The foregoing problem is intended to be solved at the current stage of reforming and development of the pension system which began in 2013 and associated with creation of ENPF with absolute participation of the state, all mandatory pension savings transferring from non-state pension accumulation funds to ENPF, authorizing National Bank of Kazakhstan for storage and management by pension assets.

Current solidarity pension system in Kazakhstan is characterized by high level of public participation. Solidary system takes into account labor contribution of a citizen. We cannot say that the pension of the system is a "burden" for the state, its budget, working citizens, or that persons pension recipient is granted wrongly. Today's pensioners during their working life were involved into certain labor contribution to the creation of public wealth, in the formation of the state budget from which the financing of social security and pension was funded, i.e. by feasible contribution participated in the state system of formation and use of the society. Thus, today's pensioners of the solidarity system are recipients of the state benefits created by themselves. Therefore,

opinion that this type of pension is appointed solely at the expense of the state is incorrect.

The pension of solidarity system is indicated for the retirement age in proportion to the existing seniority and salary, although this differentiating value, in fact, is another by origin, as there are limits on the maximum size of the appointed payment, and nowadays almost everyone is assigned its maximum (mainly) or minimum value. In fact, pension is not differentiated by branch of economic activity. Thus, the same amount maximum of pension will be assigned to a teacher, to a doctor, to a driver, to an accountant, to a judge, or to a minister who has the necessary working experience.

The next differentiating indicator – the general seniority – can be regarded as a such with a high degree of conditionality. Although the law determines that the maximum pension amount is set at the proper length of service but its increase of one per cent above the required is not a differentiating circumstance. This is compounded further by the presence of the maximum value of pensions and restricting the amounts of income to determine its size.

The stated retirement age in the country, actually, does not reflect the actual citizens' living age. The first value relatively to the male half of the population is too high. Men almost always die before retirement age of 63 years old. Those who crossed retirement age generally use the minimum (so-called survival age) for receiving pension payments. The main direction of the pension reform in 1998 became, firstly, gradual increase in the retirement age from 55 to 58 years for women and from 60 to 63 for men. Increasing the retirement age implies a higher level of savings in the pension system. However, in practice this has led primarily to a sharp decrease in the number of pensioners receiving a pension from the solidarity system.

Secondly, it was canceled almost all soft base (conditions more early) retirement, as a larger number of benefits in the appointment of pensions created a significant burden on the State pension fund. Current legislation granted to a significant number of citizens a right to retire earlier and receive preferential pensions, the amount of which in some cases was higher than old age pensions. As a result, employees of some sectors paid the fees for the payment of pensions to working in the privileged sectors that led to violation of the social justice principles. Currently, in the Law "On pension security" remained only two categories of citizens entitled to earlier retirement.

Third, social disability and loss of breadwinner pensions were canceled and replaced by corresponding types of state social benefits. In our opinion, this substitution of one type of social security on the other was due to the economic reasons for the lack of sufficient funds for their financing. Since the minimum monthly pension are approved annually by the legislative act on the basis of cost of living, based on the principle of gradual increase it up to the subsistence level, the size of the considered state benefits with any social indicator was not involved. Therefore, the sizes of prescribed social benefits were often significantly less than the subsistence level of the average for the republic and the minimum pension for the relevant calendar year.

Fourth and most importantly, the direction of the pension reform was the introduction of a funded pension system, along with the existing joint as previously existing pension system in the legal, economic and social relations needed fundamental changes. Reforming the pension system had to facilitate

development of the state economy on which improvement of material support of all pensioners depends. Funded system assumes responsibility of each person for their future pension which is financed from private pension savings and received investment income. Thus, the level of pension provision has become differentiated, depending on labor contribution of citizen in the system and success of the accumulative pension funds, organizations engaged in investment management of pension assets.

## Discussion

In a relatively short period of its existence the accumulative pension system several times was substantially reformed in order to protect the interests of depositors and recipients, ensure the safety of pension savings without changing the fundamental principles of its functioning: the obligatory participation of every citizen of working age in the formation of pension savings, personal responsibility of able-bodied citizens for their pension in old age; effectiveness of investments in conjunction with the safety of pension savings; ensuring citizens' rights of succession to the accumulation in the pension system; contribution to the economy through the investment of citizens' pension savings.

The pension system and, accordingly, the whole social security system is in the process of continuous improvement. Some innovations claim to recognition as a continuation of the pension reform. The first restructuring period from 1998 to 2013. It can be characterized by the development of the pension system in the following areas:

- usage of existing and creation of new security tools financing of pension savings;
- State guarantees the safety of pension savings;
- ensuring the right to a pension on preferential basis to persons engaged in labor activity in special conditions;
- increasing the level of social security for persons with disabilities, persons who have lost their breadwinner to a living wage;
- coverage of social security system of social risks, and others.

The current stage of the pension system development is associated with the adoption and entry into force of the new Law "On pension provision in the Republic of Kazakhstan" dated June 21, 2013. The following innovations have been made in the pension system of the Republic of Kazakhstan:

- creation of a common accumulative pension fund;
- introduction of mandatory occupational pension contributions;
- unification of retirement age.

Common accumulative pension fund shall be established in the form of a joint stock company which is a non-profit organization. The sole shareholder of the Fund is the Government of the Republic of Kazakhstan. CAPF became the only organization carrying out the involvement of compulsory pension contributions, compulsory professional pension contributions, record keeping individual pension accounts and work pension payments from pension savings, and can accumulate voluntary pension contributions at the option of the citizens themselves. The management by CAPF pension assets is carried out by the National Bank of Kazakhstan on the basis of the agreement on trust

management concluded between the National Bank of the Republic of Kazakhstan and the CAPF. The investment strategy is determined by the Council for CAPF pension assets management, advisory and consultative authority under the President of the Republic of Kazakhstan. Pension assets are stored in the National Bank. It keeps a record of all the accumulation of pension assets operations, their placement and to obtain investment income. Such consolidation and management of pension assets under the supervision of the National Bank of Kazakhstan will allow to dispose citizens' savings more effectively and safely.

On compulsory pension contributions, compulsory professional pension contributions saved the state guarantee for the safety of pension savings. Mandatory occupational pension contributions shall be made in the amount of 5% of the employer's assets, while maintaining previous mandatory pension contributions. New system applies only to those workers who are employed in industries with hazardous working conditions. List of industries, jobs, trades workers, in whose favor the mandatory occupational pension contributions, approved by the Government and shall be reviewed periodically. Increasing of the retirement age level for women will be implemented in stages, starting from January 1, 2018, during next 10 years.

Increasing of the retirement age level for women should increase the length of women's participation in the pension system and the increase in the volume of pension savings. Therefore, it should lead to an increase in the size of the pensions of the accumulative pension system.

It is expected that it will allow:

- to hold it painless for people close to retirement age;
- to prepare psychologically and to adapt to the new environment (the generation that will retire within 63 years);
- to take measures for expanding productive employment opportunities for women.

## Conclusions

Pension reform and the associated processes are continuing in the legal sphere of the state as the necessary tools for implementation of constitutional guarantees for the citizens' pension rights in the Republic of Kazakhstan. The authors believe that the further modernization of the pension system will be aimed at improving social protection of people of retirement age, ensuring financial sustainability of funded pension system in general and the further development of its institutional framework.

It must be ensured transparency control individual pension accounts, efficient management of the investment portfolio and pension payments, comparable replacement of citizens' income by pension payments. This will help to increase public confidence in the pension system. There should be developed at the national level and adopted a special policy document – the Concept of further modernization of the pension system on a 20-year term. It must be ensured an increase in the coverage of the pension system and developed mechanisms for effective investment of pension assets in the projects of the most promising sectors of the economy. Modernisation of the pension system should

be based on the further strengthening of joint responsibility of the state, employers and workers themselves for the pensions of citizens.

### Disclosure statement

No potential conflict of interest was reported by the authors.

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