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Reversing Pension Privatization in Kazakhstan

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Abstract

This paper documents the reversal of pension privatization and the reforms that took place in the 1990s and 2000s in Kazakhstan. The report analyses the political economy of different reform proposals, and the characteristics of the new pension system, including laws enacted, coverage, benefit adequacy, financing and contribution rates, governance and social security administration, social dialogue, positive impacts and other key issues of Kazakhstan's pension system.

JEL Classification: I3, H53, H55, J14, J26

Keywords: pension privatization, pension reform, social security policy

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Acronyms

ADB	Asian Development Bank
AFN	Agency for the Regulation and Supervision of Financial Market and Finance Institutions
PPFA	Private Pension Fund Administrator
BSP	Basic Social Pension
UPF/ENPF	Unified National Pension Fund (in Russian, Edinyi Natsional'nyi Pensionnyi Fond)
GDP	Gross Domestic Product
ILO	International Labour Organization
MSL	subsistence minimum
NBRK	National Bank of the Republic of Kazakhstan
OECD	Organisation of Economic Cooperation and Development
PAYG	Pay-as-you-go
RK	Republic of Kazakhstan
SAPF	Public Accumulation Pension Fund
SOE	Public enterprises
UPF	Government unified pension fund
USAID	United States Agency for International Development
USSR	Union of Soviet Socialist Republics
WB	World Bank

Summary of Reforms related to Pension Privatization and its Reversal

1998	**The pension system following the 1998 privatization:** 1st Pillar: mandatory funded and privately-managed, defined-contribution pension system based on individual accounts 2nd supplementary occupational pension plans. 3nd Pillar: voluntary pension system (also funded and privately managed) to provide for additional savings and insurance. The solidarity pension (0 Pillar) was phased out as people in the pre-1998 pension system retire.
2004	**Introduction of the social security rate.** **It is charged to companies and covers social programs including pension, healthcare, and many other benefits. The rate averaged 26.6 per cent since 2004 and is now at 11 per cent (July 2018).**
2005	**Introduct**ion of **the unconditional, universal Basic Social Pension (BPP).** (Reformed in 2017).
2013	**Reversal of the privatization and rebuilding a public pension system:** Law No. 105-V ZRK of 21 June 2013 «On Pensions in the Republic of Kazakhstan» **The new model**: 0 Pillar: Basic Social Pension (BPP) (unconditional, universal pension payment) 1st Pillar: Fully-funded, individual-account, defined-contribution pension (mandatory – managed by the new public Unified Pension Fund (UPF); 2nd Pillar Occupational pension (high-risk employment). Plus a Solidarity pension PAYG paid by the government to citizens employed no less than six months before January 1998. 3rd Pillar: Voluntary pension scheme of the UPF. **Rights and ntitlements:** Universal non-contributory pension is available from the age of 63 (men) and 58.5 (women) with a monthly benefit of up to US$ 82.50. Individual-account pension is available for citizens of the above pensionable ages or with sufficient funds accumulated. **Administration:** The BPP and solidarity pensions are managed by the government. Creation of the Unified National Pension Fund (UPF) for the administration of individual accounts. The UPF is jointly managed by the National Bank and the Council for Pension Assets Management under the President of the Republic of Kazakhstan. **Transfer of entitlements**: All individual-account funds and members were transferred automatically to the new public administrator, the UPF. Entitlements under the individual-account scheme are recognized under the defined-contribution formula. **Contributions:** The UPF is the public administrator and operator of financial and information flows, including contribution collection. Workers contribute 10 per cent to the individual account scheme. Employers contribute 5 per cent to the occupational pension scheme. **Supervision:** The Agency for the Regulation and Supervision of Financial Market and Financial Institutions (AFN) oversees the National Bank and its operations, including pension-fund management. **Solidarity and social impact:** The non-contributory Basic Social Pension and Solidarity Pension improved benefit adequacy for low income groups in particular, improving overall equity in the system. The government further gained access to long-term financing for public projects. **Fiscal impact:** As the individual-account scheme is still in operation, it is unlikely to have a significant impact on the fiscal position of the government.
May 2014	Announcement of the reform of the unconditional, universal BPP to a scheme where benefits are also linked to contributory records.

1. Introduction: Kazakhstan's pension system in transition

Following a decade of painful economic and social reforms, Kazakhstan is emerging as a dynamic economic and political actor in Central Asia (Dave, 2007). During the past decade, the country has undergone significant policy reforms, progressing towards a rules-driven fiscal framework, a more solid public management and business climate, and allocated resources for improving social services and infrastructure that support sustainable growth (OECD, 2014). Since 2000, Kazakhstan has been one of the fastest-growing economies in the world, performing well even during the 2008 financial crisis.

Kazakhstan made significant gains in social development, with the country's Gender Inequality Index improving by more than 30 per cent between 2000 and 2012. In 2013, Kazakhstan ranked 70th on the Human Development Index, 10 places higher than its 2005 ranking (UNDP, 2014). Sixty-eight per cent of Kazakh women over age 15 were economically active in 2013 (World Bank, 2015). With a female-to-male ratio of 0.91 in 2014, Kazakhstan ranks 24th among 142 countries in terms of female participation in the labour force (World Economic Forum, 2014).

Yet despite such a remarkable transformation, Kazakhstan is still facing several challenges that threaten to undermine its sustainability and economic growth. These challenges include growing regional disparities in wealth distribution, persistently high poverty rates, particularly in rural areas and single-industry towns, and a significant gap between male and female life expectancy (62.3 for men and 71.7 for women). In addition, despite women's active participation in the labour force, the level of female political empowerment remains low (World Economic Forum, 2014). Corruption, limited human capital and a lack of active citizen participation in political processes also give serious cause for concern (see, for example, Amagoh and Bhuiyan, 2010; Bakenova, 2008; Duvanova, 2008; Emrich-Bakenova, 2009; Janenova, 2010; Perlman and Gleason, 2007; and, Knox, 2008).

The dramatic economic transition from the former Soviet Union led to concerns regarding the sustainability of the Soviet pay-as-you-go (PAYG) system to provide pension benefits to an increasing number of pensioners. In response, the government proposed a pension reform in the 1990s. On the advice of the World Bank (WB), the Asian Development Bank (ADB) and the United States Agency for International Development (USAID), the Kazakhstani government agreed to a radical pension reform. The Pension Law, passed by Parliament in July 1997, went into effect on 1 January 1998, providing the basis for the replacement of the PAYG system with a new fully-funded pension system based on individual accounts. Critics of this radical privatization at the time suggested that its emphasis on the technocratic elements of pension reform, without taking into consideration social issues and the adequacy of pension benefits, could lead to protests and declining levels of old-age social security – thus undermining the system's overall sustainability. This view was also shared by the International Labour Organization (ILO).

By 2012, the radical new pension system displayed several institutional and economic deficiencies. As a result, in 2013, Kazakhstan introduced the Unified Pension Fund (UPF) [1], practically reversing the privatization that was initiated 15 years earlier. The reform introduced a new pension tax on employers and raised the retirement age for women from 58 to 63 to make the retirement age equal for both sexes. While the principal

[1] "UPF" is the Russian abbreviation of the "Unified National Pension Fund" (Edinyi Natsional'nyi Pensionnyi Fond).

argument of the Labour Ministry and the National Bank was that the reform would create the necessary conditions for ensuring the pension system's financial stability and transparency, and that several European economies had already resorted to similar measures to reduce their budget deficits, the pension reform quickly led to heated debates and a wave of protests. Public debates and protests generally focused on women's increased retirement age, although the merging of all private pension funds into a single UPF was also discussed, albeit to a lesser extent by fewer actors.

In response to the barrage of criticism, the president of Kazakhstan signed the Law on Pension Provision in the Republic of Kazakhstan, as well as amendments to some legislative acts on pension provision, which provided for the gradual increase in women's retirement age from January 2018 forward, enabling the Kazakhstani authorities to implement the reform.

This study of the pension system reform is based on the analysis of primary and secondary data, including Kazakhstan's pension legislation, books, scholarly articles, reports and conference proceedings. To confirm the findings, the authors contacted 10 experts and civil society activists familiar with the pension reform, six of whom agreed to be interviewed. The collected interviews were based on a questionnaire developed by the authors, although the respondents had the opportunity to share additional information with the interviewers. The authors also observed how the system operates on the ground by visiting eight offices of the UPF in the Kazakhstani capital, Astana, as well as in Almaty and Atyrau.

2. Kazakhstan's pension system before 2013

Key characteristics of the Soviet pension system

Following the collapse of the Soviet Union, Kazakhstan underwent a dramatic economic transition that put great strain on the Soviet PAYG pension system. The key features of the Soviet PAYG system were:

1. Nearly universal coverage on pensions calculated based on earnings, and taking into account years of service and child caretaking [2];

2. Pensions were financed through contributions and paid by employers and through budget transfers;

3. Relatively low retirement age (60 for men and 55 for women), with the possibility of early retirement for selected groups, such as people working in arduous and hazardous conditions [3];

[2] Special rights were given to people working in listed occupations such as milkmaids, bus drivers, aviation employees, the police, the military, theatre performers, wind instrument players, etc.; dwarfs; persons working in hazardous conditions – for example, in the chemical, metallurgical and mining industries; and persons working in extreme weather conditions.

[3] For example, milkmaids, goat herders, miners, mothers of more than three children, and several other categories.

4. Replacement rates at 60 per cent of the highest past wages averaged over 12 months for workers with a full employment record, with 1 per cent extra for each year of service over 25 years for men and 20 years for women;

5. High average replacement rate that often exceeded two-thirds of the workers' previous highest wages; and

6. A generous system of non-contributory social pensions for those with insufficient employment histories, set at the minimum-wage level (Falkingham and Vlachantoni, 2012; Matthews et al., 1989).

Ultimately, the generosity of the Soviet pension system caused it to experience fiscal difficulties even before the breakup of the Soviet Union (Falkingham and Vlachantoni, 2012).

The Soviet pension system during the 1990s

The fiscal pressures on the Soviet PAYG system increased during the economic transition in the 1990s. The generous Soviet-era pension law that allowed for early retirement (53 for women, 58 for men) with at least 25 years of service for men and 20 years for women if they were unable to find new employment after layoffs or closures, as well as the deteriorating economic outlook during the early 1990s led to significant levels of early retirement (Seitenova and Becker, 2004). According to a 1996 household survey, 32 per cent of pensioners were under 60 years of age (Palmer, 2007).

The economic collapse during the transition years contributed to the sharp rise in unemployment and informal and underemployment, thus affecting the number of formal-sector workers whose contributions were essential for the financial stability of the PAYG pension system. By 1995, formal-sector employment had fallen by more than 30 per cent relative to 1991, and by 1997, the decline was already at 50 per cent. As a result, the pension system's dependency ratio, defined as the ratio of pension benefit recipients to the number of social insurance contributors, had increased significantly. In 1980, there were 30 pensioners per 100 workers; in 1997 and 1998, this number had risen to 73 and 83, respectively (Seitenova and Becker, 2004).

The growing number of pension recipients and the deteriorating dependency ratio contributed to rising government pension expenditures, from 5.45 per cent of GDP in 1989 to 7.87 per cent in 1996. Inflation and the decision not to index pension payments for inflation somewhat minimized the fiscal pressure, but also resulted in the overall decline of the minimum pension level and in growing poverty (Seitenova and Becker, 2004). In sum, these developments undermined the government's capacity to manage and finance its welfare system and greatly affected the well-being of Kazakhstani pensioners.

Social and demographic processes in Kazakhstan during the 1990s

The overall demographic situation in Kazakhstan changed significantly during the transition. Fertility rates declined from an average of 2.8 children per woman in 1989 to 2.3 in 2009. The economic situation contributed to a much steeper decline in birth rates than a typical trend would have suggested, as many families adjusted their family planning in response to the economic constraints (Falkingham and Vlachantoni, 2012). The deterioration in life expectancy at birth during the 1990s was staggering, falling from 63.9 in 1989 to 58.0 in 1996 for men, and from 73.1 in 1989 to 71.5 in 2009 for women (Falkingham and Vlachantoni, 2012). The 1990s were also characterized by the significant emigration of the working-age population from Kazakhstan to other countries, particularly the Russian Federation. An estimated 1.5 million people left the country during this period. The decline in fertility rates, outward migration and a gradual increase in the over-60 population explain the significant shift in the age composition of the Kazakhstani population.

To summarize, the key factors that contributed to the implementation of the 1998 pension reform were high unemployment, weak economic performance, the ageing population, negative trends in the pension system's dependency ratio, the evasion of tax payments and pension contributions owing to a large informal sector, and the gap between the size of contributions and pension benefits.

The Kazakhstani 1998 pension reform in the context of the post-Soviet economic transition

By the mid-1990s, the problems of pension sustainability and provision had become especially pressing. The changes in Kazakhstan's pension system shortly before and after its independence, coupled with the demographic trend, the fall in GDP, high inflation and growing levels of unemployment, underemployment and informal employment, contributed to an acute budget deficit, leading to pension debt and the government's inability to ensure minimal levels of social security. In late March 1997, pension arrears stood at 26 billion tenge (equivalent to three months of payments) (World Bank, 1998). Responding to widespread public discontent with delays in the payment of pensions and wages, the government increased its deficit and attempted to clear all pension and wage arrears in 1997 [4].

At this point, there was a growing realization that the existing pension system required reform. The question was whether the PAYG system could be maintained by making parametric adjustments as recommended by the ILO, or whether a completely new pension system should be adopted. During this time, calls for radical pension reform became more popular among local politicians and international policy actors such as the World Bank (WB), the International Monetary Fund (IMF), the Asian Development Bank (ADB) and the United States Agency for International Development (USAID), which argued that the old Soviet solidarity pension system caused growing socioeconomic instability (BBC Monitoring Service: Former USSR, 25 April 1997; Kazakhstanskaia Pravda, 10 April 1997). In this context, the Kazakhstani government, led by Prime Minister Akezhan Kazhegeldin, with technical and financial support from the ADB and the WB, designed a private pension-fund system that resembled the Chilean pension model. The goals of the new pension system were to promote self-sufficiency instead of government dependence, reduce government expenditures, encourage saving and develop the capital market (Seitenova and Becker, 2004) [5].

The basic model of the proposed 1997 Kazakhstani pension reform relied on a concept introduced by the WB in its report *Averting the Old Age Crisis* (World Bank, 1994). The report advocated for the implementation of a multi-pillar pension system,

[4] Resolution of the Government of the Republic of Kazakhstan No. 186a, 10 February 1997; Resolution of the Government of the Republic of Kazakhstan No. 1022, 26 June 1997; Order of the Prime Minister of the Republic of Kazakhstan No. 106, 18 April 1997. Access to these documents is available at *Yurist – Kompleks Pravovoi Informatsii* [Lawyer – Database of Legal Information]. Link: http://online.zakon.kz. See also Aubakirov, 1997; Bul'dekbaev, 1997; *Reuters*, 16 June 1997.

[5] See also: Bird, 1997; Kokovinets, 1998; and Andrews, 2001.

which consisted of a mandatory PAYG public pension system designed to provide an income floor for all elderly persons (Pillar 0); a mandatory funded and privately-managed, defined-contribution pension system based on individual accounts (the Latin American approach) or occupational plans (the OECD approach) (Pillars 1 and 2); and a voluntary system (also funded and privately-managed, to provide for additional savings (Pillar 3) (World Bank, 1994).

The draft of the new pension reform was presented in October 1996. The proposed pension reform formed part of a broader package of socioeconomic transformation, comprising three components: the privatization of public enterprises (SOE), the development of a securities market and the establishment of private pension funds (Becker et al., 2009). It was hoped that public offerings of SOE shares would help jump-start Kazakhstan's capital market, while revenue from the privatization of SOE would help finance the transition from a PAYG system to a fully-funded pension system (Becker et al., 2009; Khakimzhanov, 2015, personal communication, 8-9 June).

Kazakhstan's new Pension Law No. 136-I was passed on 20 June 1997 and went into effect on 1 January 1998. The reform transformed Kazakhstan's pension system from a solidarity-based system to the one based on individual accounts to be maintained either with the newly established Public Accumulation Pension Fund (SAPF) or with non-governmental (privately owned) pension funds (NSAPF). It also raised the retirement age from 60 to 63 for men, and from 55 to 58 for women (Kazakhstanskaia Pravda, 8 April 1997 and 20 March 1998; Solov'iev, 1997; Andrews, 2001; *The Economist*, 29 May 2003).

The Kazakhstani government went even further than the Chilean system toward a fully privatized system and the elimination of solidary old-age pension security, freezing all accruals under the old redistributive solidarity system and immediately transferring workers of all ages to the new system of mandatory individual accounts. The reform enabled retirees who had accrued benefits prior to 1998 to retain the right to receive their benefits under the old solidarity pension system but terminated the solidarity pension benefits for all other population groups. In other words, the mandatory, publicly funded pre-1998 pension would exist only for as long as there were workers with accrued rights. Essentially, it meant that the two systems operated in parallel. However, because workers with pension benefits accrued under the old solidarity pension system retire, the public pension scheme is meant to be phased out within the next 30 years (Hinz et al., 2005).

Assessment of the structure and performance of the Kazakhstani privatized pension system

The government expected the development of a fully privatized pension system and the privatization process to strengthen the capital market, believing that citizens' active participation in the new system and the higher returns of private pension funds would facilitate the payment of adequate pension benefits in the future. However, none of these expectations fully materialized (Khakimzhanov, 2015, personal communication, 8-9 June). Concerned about the volatility of the international markets and possible exchange and liquidity risks if investments were made in foreign securities, but also restrained by government investment regulations and encouraged by the government to contribute to the development of the local capital market, Kazakhstan's Private Pension Fund Administrators (PPFA) chose to invest primarily in government securities. Few other quality assets were available on the domestic market. As of January 2013, most of the investment portfolio of pension funds was concentrated in the country: in national government securities (50.5 per cent), corporate securities (25.9 per cent) and bank deposits (10.4 per cent). Only 7.2 per cent of the investment portfolio was invested in public and private securities of foreign issuers (National Bank of the Republic of

Kazakhstan, 2013). Overall, due to the strict capital requirements and government restrictions on investment, pension funds failed to develop the capital market or support the economy and the performance of the pension system (Gorst, 2013).

Given the weak rule of law and underdeveloped financial markets, the introduction of a fully privatized pension system came at a price, in the form of non-transparent deals, weak governance in the private sector and high service fees and operational costs (Zhandildin, 2015, personal communication, 4 July; Yesirkepov, 2013). Compared with 2010, in 2011 revenues of PPFA fell by 6 per cent, whereas expenditures increased by 16 per cent, and general and administrative expenses, in other words, non-production costs that are spent on PPFA staff, rose by 17 per cent and payroll by 18 per cent. Despite the catastrophically low levels of profitability, Kazakhstan's PPFA continued to spend more than they earned (Yesirkepov, 2013).

In addition, during the 2007-2008 financial crisis, the PPFA pension funds were used to rescue banks and other financial institutions, whose shareholders were also PPFA shareholders. For example, before the crisis, the country was literally booming with corporate issuers, which largely focused on the pension money. During the crisis, a significant portion of bond issuers defaulted, resulting in billions of dollars in losses suffered by the PPFA (Yesirkepov, 2013). In 2011, in response to this situation, the government limited the use of pension funds in financial operations to no more than 8 per cent for PPFA whose pension assets exceeded 130 billion tenge. In 2012, the government stipulated that no single shareholder could own more than 25 per cent of PPFA funds (Yesirkepov, 2013).

Transparency has been an issue for PPFA as most did not reveal the structure of their share capital, and in some instances no shareholders were listed at all (Yesirkepov, 2013). Moreover, some PPFA did not even have official websites. For Kazakhstan's fully-funded, privately-managed pension funds to operate effectively, a dynamic domestic financial market, greater system transparency, a solid rule of law and the adequate regulation and supervision of pension funds, asset managers and other financial intermediaries were all essential. In practice, none of these conditions were fully met.

The 1998 pension reform also failed to achieve high replacement rates, or to enhance pension coverage and compliance as expected. The low returns on investments, which averaged 3-4 per cent, made the goal of attaining the 60 per cent replacement rate the government had promised at the beginning of the reform largely unattainable. As the director of the Centre for Macroeconomic Research, Olzhas Khudaibergenov, said in 2013: «Currently, half of the savings are invested in government securities, for which the average rate of return is 6 per cent annually. This year, the pension system showed a rate of return of 3 per cent. This means that the other half of the assets did not generate revenue. The government runs the risk of eventually failing to achieve its own guarantee» (Yesirkepov, 2013). The insufficient performance by the first pillar (individual accounts) and the limited presence of the 0 pillar (being phased out) contributed to the low replacement rates, which were 27.36 per cent in 2010 and 29.27 per cent in 2013 (Zhandildin, 2015).

The situation in terms of pension coverage and adequacy was no better. According to official statistics, in 2013, the new pension scheme covered 8.5 million people, representing 80 per cent of the economically active population (News-Kazakhstan, 8 August 2013). However, the WB's 2011 World Development Indicators stated that 65 per cent of the labour force in Kazakhstan did not contribute to a retirement pension scheme (Abdih and Medina, 2013). This especially concerned the self-employed workers in the informal sector or/and the unemployed, who remained on the socioeconomic margins of society.

Likewise, the new system failed to provide adequate old-age income security to a significant number of people with low earnings, shorter, fragmented careers, and/or a lack of official employment records, all of which especially affected women. This problem was particularly serious for women born between 1948-1950 who retired before 1998 during the economic stagnation. Because of the negative economic effects of the transition period during the 1990s, these women were unable to provide proof of their most recent employment and average salary. Because of the interruptions in their employment record and low earnings, many of them received a minimum pension only. The weakly-developed labour market also prevented pensioners from accessing well-paid jobs at older ages. In response, in June 2005, the government introduced a universal basic social pension [6] that was not conditioned on contributions and employment history.

The new basic pension was set at 3,000 tenge per month, about 40 per cent of a subsistence income, and it was scheduled to be adjusted on a yearly basis, reaching a target of 75 per cent of subsistence sometime in the future. Since January 2015, the government basic pension has increased to 11,182 tenge (US$ 60), with the minimum pension set at 23,692 tenge (US$ 127), and the minimum subsistence level for the calculation of basic social payments rates was fixed at 21,364 tenge (US$ 114) (Government of the Republic of Kazakhstan, n.d., Size of Pension Payments in 2015). Individuals receive the basic pension in addition to the one earned under the residual former solidarity system and the fully-funded accounts.

To finance the existing pension and welfare obligations, the government introduced the Social Security Rate, a tax related to labour income charged to companies and collected to pay for many social programmes, including welfare, healthcare and several other benefits. The Social Security Rate in Kazakhstan averaged 26.60 per cent from 2004 until 2018, reaching an all-time high of 33 per cent in 2005 and a record low of 11 per cent in 2017. Currently, it stands at 11 per cent (July 2018) (Kazakhstan Social Security Rate 2004-2018, n.d.). The introduction of the basic social pension in 2005 guaranteed minimum income security to all citizens in old age. Following its introduction, the minimum level of pensions rose immediately by nearly half – from 620 tenge in 2005 to 1,0270 tenge in 2009, and the average pension has also increased significantly since 2005 (Kurmanov, 2011). All other issues related to the performance and quality of the Kazakhstani pension system discussed earlier remained unaddressed.

3. The 2013 reform: Key characteristics

Basic characteristics of the new pension system

Kazakhstan currently has a multi-pillar pension system, which consists mainly of universal, mandatory and voluntary pillars (Table 1).

[6] *Базовая пенсия* in Russian.

Table 1. Kazakhstan's pension system

Pillar 0	■ Basic Social Pension (BSP) (universal and unconditional pension payment)
Pillar I	■ Fully-funded, individual-account, defined-contribution pension (mandatory – managed by UPF) (10 per cent contribution rate for workers)
Pillar II	■ Occupational pension (for high-risk professions) (5 per cent contribution rate for employers) ■ Solidarity pension: the pre-1998 government PAYG pension is being phased out, but as long as there are still workers or pensioners with at least six months of employment before January 1998, the PAYG pensions will continue to be paid.
Pillar III	■ Voluntary pension scheme of the UPF

The zero pillar consists of the basic social pension (BSP). All citizens who have reached retirement age receive a BSP. The BSP is an equal amount for all, regardless of work experience and salaries. In 2018, the minimum base pension is 15,274 tenge or US$ 45, corresponding to 54 per cent of the minimum subsistence level (MSL). Since 1 July 2018, the BSP also increases with years of employment, for a maximum of 100 per cent of the MSL (Government of Kazakhstan, 2018).

The first pillar is based mainly on a mandatory individual-account pension scheme with a fixed 10 per cent contribution rate paid by workers. The ceiling is 75 times the minimum wage or 2,121,300 tenge in 2018 (equivalent to US$ 6,184.50) and the minimum cannot be less than the minimum wage (28,284 tenge in 2018, equivalent to US$ 82.50).

The second pillar consists of the occupational pension scheme with mandatory contributions for workers employed in high-risk professions (for example, natural resource extraction), with a contribution rate of 5 per cent paid by employers (Ministry of Health and Social Development of the Republic of Kazakhstan, 2012) [7]. Corporate tax deductions were supposed to ease this additional burden on employers and it was claimed that this new regulation would create incentives to improve working conditions. Employers can obtain a certificate confirming that their employees' working conditions are not hazardous, exempting them from the occupational pension contributions (Telemtayev and Adjivefayev, 2014).

Pension savings in the UPF are placed in individual accounts belonging to each member. In the event of a contributor's death, his or her pension savings are transferred to his or her heirs. The minimum guaranteed pension is 54 per cent of MSL. The second pillar also includes the solidarity pension PAYG system inherited from the Soviet Union. The solidarity pension is financed through the government budget, paid to every employee with at least a six-month employment period prior to January 1998. With full employment periods of 25 years for men and 20 years for women, the replacement rate is 60 per cent, which increases 1 per cent for every additional year up to 75 per cent (Government of Kazakhstan, 2018).

The implementation of an additional notional defined-contribution pension financed through a contribution rate of 5 per cent paid by employers (which was set forth in the concept paper on the continued modernization of the pension system until 2030, published 18 June 2014) was postponed until 2020. Pension savings in a notional account do not belong to beneficiaries and therefore cannot be inherited by their heirs.

[7] In January 2012, 346,600 people were engaged in hazardous employment or worked under other adverse conditions.

The third pillar is a private, voluntary pension scheme. It aims to increase individual savings and thus to secure a higher income upon retirement. Contributions of up to US$ 50 are tax-exempt. Rates and terms of payments of voluntary pension contributions are established in the contract agreement negotiated by the UPF and a voluntary payment contributor. Pension payments from voluntary pension savings are paid out when the worker reaches age 50 under the terms set in the agreement.

Legislative and institutional changes and coordination mechanisms

The Law on Pension Provision in the Republic of Kazakhstan (21 June 2013), prepared by the Ministry of Labour and Social Protection and the NBRK, introduced the following changes to the 1998 fully- funded pension system:

1. Creation of a single pension fund, the UPF;

2. Transfer of all pension assets and obligations of the operating PPFA to the UPF;

3. Assignment of the management function of pension assets held by the UPF to the NBRK, and creation of the advisory board under the president of the Republic of Kazakhstan, the Council for Management of Pension Assets of the UPF;

4. Introduction of a mandatory 5 per cent contribution paid by employers on behalf of their workers in high-risk professions; and

5. Increase in the retirement age for women from 58 to 63.

A non-profit organization in the form of a joint stock company, the UPF was established in 2013, taking over all pension assets from the PPFA (Government of the Republic of Kazakhstan, 2013b). By 2014, the UPF had assumed responsibility for the management of all mandatory and voluntary occupational pension contributions (Kuandyk, 2014).

In other words, following the 2013 pension reform, the government became the UPF's sole shareholder, whereas the NBRK provided custody and accounting of the UPF's pension assets. The investment management of the UPF's pension assets was also transferred to the NBRK (UPF, n.d., History). The new fund will focus on investments in infrastructure projects; consequently, it is expected that it will invest less in private securities.

Following the reform, the quality of the UPF's customer services noticeably improved. It opened several new offices in Astana that were organized based on the example of the Kazakhstani One-Stop Shops (Tsentry obsluzhivaniia naseleniia). The UPF has 18 regional branches –one in each regional centre and in the cities of Astana, Almaty, Zhezkazgan and Semey. In total, the UPF currently operates 236 regional offices, with plans to open six additional service offices in Almaty, Astana, Karaganda and Pavlodar.

The second important change in the pension system concerned women's retirement age, which triggered heated debates and protests, with the active involvement of civil society and women's rights groups. Initially, the government suggested raising the retirement age for women from 58 to 63 starting in 2014. Later, however, the massive protests against the reform persuaded the government to postpone the implementation date to 1 January 2018 and suggested a phase-in period of 10 years (increasing retirement age by six months every year). Some groups retained the right to early retirement at age 53, including women with five or more children who had a total employment record of 20+ years, and women who lived and/or are still living in emergency zones for at least 10 years and who were exposed to high radiation risk between 1949 and 1963.

While many people criticized the decision to raise the retirement age despite the increase in life expectancy, others pointed to several positive developments in this regard. Some experts argued that raising the retirement age would empower women to engage in productive employment. Critics claimed that many people approached retirement with several different, often serious, health conditions and would not live long enough to receive their pensions. Opponents of the pension reform also warned that an increase in the retirement age for women would inevitably lead to a shortage of jobs.

Responding to this criticism, the government stated that more than 500,000 jobs would be created by 2020 to keep the unemployment rate at 5 per cent (Government of the Republic of Kazakhstan, n.d., Business Roadmap for Employment – 2020). It promised to address the structural problems of the labour market and to introduce measures to improve the skills of women workers through on-the-job training; engage self-employed women in the Employment Programme 2020; and, improve access to microcredit for women working in a business or willing to start their own business. Additionally, the Initiative 50+ programme was implemented to facilitate the employment of people over age 50, and the Labour Code was amended to eliminate discrimination during employment and to guarantee continued employment for employees over age 55.

In short, the 2013 pension reform purportedly sought to address several demographic, socioeconomic and organizational weaknesses of the pension system since the introduction of the 1998 pension reform. Officially, the modernization of the pension system in 2013 was designed to provide an adequate standard of living at retirement age by enhancing the contributory capacities of citizens and improving the effective management of pension assets through greater transparency and accountability (UPF, 2014). At the same time, the government hoped to use the pension funds to invest in the national economy, thus suggesting that the government's economic strategy was focused on government-led development. The new pension reform did not change the contributory nature of the Kazakhstani pension system as it maintained the individual pension accounts as the primary instrument of pension provision.

In May 2014, the health and social development minister announced plans to modify the BSP (Khabar.kz, 17 February 2015; Zakon.kz, 14 May 2014). Beginning on 1 July 2018, every citizen regardless of employment period (career and length of service) is entitled to a BSP at the minimum rate of 54 per cent of the MSL, which is 15,274 tenge today or US$ 45.00. This base pension is increased by 2 per cent for every year beyond a 10-year contribution period in the public pension system. For an employment period of 33 years or longer, the BSP will reach the maximum rate of 100 per cent of MSL (28,284 tenge, equivalent to $82.50 US$). The MSL is indexed for inflation annually, so the BSP rises with inflation.

The government also proposed the introduction of new employer contributions. By 2020, employers will make additional contributions of 5 per cent, in addition to the existing 5 per cent they pay in certain professions (occupational pensions for high-risk professions). These contributions will not be deposited into individual pension accounts but rather will be used by the government to pay pensions under the PAYG system.

According to Duisenova (2008), the new system will allow for a replacement rate of 40 per cent and above. However, critical observers have suggested that the introduction of a new employer contribution may promote the informal economy. According to a senior analyst of ROI Analysis: «To meet the new requirements, employers will have to either cut the incomes of their workers so as to avoid cost overruns or start paying so-called ‘grey wages’» (Urazova, 2014). The government should consider ways to address current and anticipated weaknesses of the Kazakhstani pension system to ensure that it is effective, transparent and fair.

4. The 2013 reform: How was it done?

Sequence of reforms and critical details of the implementation process

To address the causes of social instability in the 2010s, the government launched several institutional, political and socioeconomic reforms. The pension reforms took place as part of a broader reform agenda that entailed several law-enforcement and anti-corruption initiatives; steps to support employment in small, economically-depressed towns throughout the country (known as Employment Provision-2020); development of a comprehensive youth policy; establishment of a microcredit system; incentivization of internal migration from economically-depressed to rapidly-developing regions; and the implementation of several infrastructure and housing projects (Ministry of Education and Science of the Republic of Kazakhstan, n.d.; BNews, 31 January 2013) [8].

The socioeconomic modernization programme, which was part of the Kazakhstan 2050 strategy and which focused on administrative, social and economic reforms, among others, posited the idea that dependency on the government during one’s most productive years was unacceptable.

The strategy prioritized poverty prevention and the establishment of basic social standards and guarantees, with the process directly dependent on the economy and budget growth (Nazarbayev, 2014). The government also promised to pay more attention to infrastructure development, natural resource management, industrialization, the modernization of the agricultural sector and support of entrepreneurship. Further investments in Kazakhstan’s education, research, training and retraining systems were also announced.

As part of these broad reforms in 2012, the government began to develop a new concept for the pension system (Mozharova, 2013). At the request of the government, the WB prepared a report analysing the effectiveness of Kazakhstan’s pension system and offering recommendations. The report attributed the existing deficiencies of the Kazakhstani pension system to market failures and advocated for the merging of all pension funds and their placement under the management of a foreign company for investment of those funds on the international stock market (in foreign bonds) (Khakimzhanov, 2015, personal communication, 8-9 June). The NBRK, the Ministry of Labour and Social Protection and the Association of Financiers also submitted proposals on behalf of several pension funds (Bozov, 2012).

The final draft of the law incorporated several suggestions made by the WB and the NBRK. The draft followed the WB recommendation of establishing the UPF to merge all pension assets and liabilities previously held by private pension funds. At the same time, the government rejected the WB’s recommendation of placing the combined pension funds under the management of a foreign company, instead reiterating the government’s adherence to the idea of government-led economic development and entrusting the

[8] See also MetaKZ, 6 January 2012; Novosti-Kazakhstan, 7 February 2012; ARNA Press, 8 October 2012; Kazakhstan.kz, 27 January 2012.

management of the UPF to the NBRK. The head of the National Bank, Grigorii Marchenko, also defended the reform, highlighting the potential loss of US$ 19.6 billion in tax revenues by 2023 should the proposed pension reform not be adopted (Voloshin, 2013; Vestifinance.ru, 26 February 2013).

From the outset, the executive branch and the NBRK led the pension-reform. The representatives of the labour ministry travelled to the regions for community meetings, campaigning in support of the pension reform. Civil society, pension fund members and other stakeholders had minimal participation in policy consultations. Likewise, the role of the Parliament in the development of the reform was nominal and limited to the organization of a formal discussion and enactment of the law. The bill was adopted by the lower (Mazhilis) and upper (Senate) houses of Parliament on 23 May 2013. A swift, negative reaction from citizens followed, which resulted in public and parliamentary discussions of the controversial bill.

Developed without broad public consensus, the new law «On Pensions in the Republic of Kazakhstan» was heavily criticized by civil society, women's groups and private pension funds. The public perception of the reform was negative. According to some surveys, 70 per cent of Kazakhs did not support the government initiative, believing that the proposed changes to the pension system would not contribute to solving existing pension problems (Savchenko, 2013). The plan to increase the retirement age for women coincided with the government's ratification of the Maternity Protection Convention (Convention No. 183). Many women felt that the government had only ratified the Maternity Convention to please the international community while distracting the public from the government's lack of interest in enforcing the fundamental principles of the Convention. Such a perception was reinforced following the government decision to establish a cap on maternity benefits (Harkova, 2015, personal communication, 10 June). In response to these two government initiatives, the Unity of Women and the Association of Businesswomen were formed, which organized peaceful demonstrations articulating women's concerns and demanding an adequate assessment of the possible consequences of the proposed changes (Del'masheva, 2015, personal communication, 9 July).

As some women's groups and NGOs argued, the introduction of changes to the women's retirement age should have been accompanied by comprehensive reforms of Kazakhstan's labour market and healthcare systems (Harkova, 2015, personal communication, 10 June; A. Del'masheva, 2015, personal communication, 9 July). Research has shown that even though Kazakhstani women live longer than men, many women have numerous health problems that undermine their ability to work effectively after age 58, and that they are disproportionately affected by the deficiencies of the Kazakhstani labour market. Moreover, as some women argued, the introduction of a higher retirement age would dramatically affect the economic well-being and social fabric of many Kazakhstani families. Given the shortage of public childcare facilities, many young families rely on their mothers for childcare. In the absence of childcare facilities, these families would find it extremely difficult to balance their work and family obligations (A. Del'masheva, 2015, personal communication, 9 July). In short, Kazakhstan needed more jobs, economic diversification to accommodate more female workers, better employment policies and their stricter enforcement, and significant improvements in the healthcare and education systems if the government wanted to move ahead with increasing the retirement age for women (Harkova, 2015, personal communication, 10 June; Del'masheva, 2015, personal communication, 9 July).

The reaction of government authorities was mixed. Some officials expressed a willingness to discuss the policy proposals developed by the initiative. However, in other instances, such as in the City of Ural'sk (Western Kazakhstan) on 27 April 2013, local authorities banned anti-reform protests (Savchenko, 2013). In response to this criticism, Nazarbayev finally addressed the nation on 7 June. Although he criticized the Labour Ministry for its poor performance and returned the draft law to Parliament for additional discussion and voting on the timing of the retirement age increase, Nazarbayev defended the reform, stating that it was designed to better manage the eventual budget deficit problems resulting from reduced tax revenues in the coming years. He proposed to begin a gradual increase of the retirement age for women beginning 1 January 2018. The president also requested additional social protection measures, especially for women of pre-retirement age, before the new law on the retirement system goes into effect (Kazybay, 2013). The law «On Pension Provision in the Republic of Kazakhstan» was finally signed by the president on 21 June 2013.

Experts pointed to many negative aspects of the proposed «nationalization of pension funds,» as some critics called it. The following problems were identified: the violation of the rights of members, lack of competition, restriction of private enterprise, violation of the rights of private businesses, the ineffectiveness of public management, and the loss of 12,000 to 20,000 jobs in private-pension sectors. The 2013 pension reform was said to create an environment conducive to corrupt transactions, the monopolization of the market and the deterioration of market conditions for investors. This could adversely affect the profitability of pension savings and competition in the securities market (Savchenko, 2013). An open letter to the president signed by the president of the Pension Fund Association, the chairman of the Council for Pension Fund Association and the president of the Independent Association of Entrepreneurs explained the negative consequences of abolishing a competitive system of pension funds (Lukicheva, 2013). Some observers also pointed out the high risks of corruption and abuse by the UPF as the flow of funds would be controlled solely by the government, creating a monopoly.

In conclusion, the 2013 pension reform was driven more by the imperfections of the 1998 pension system, domestic political considerations and the desire to make the existing pension system an important element in the country’s modernization process (Khakimzhanov, 2015, personal communication, 8-9 June). No real policy dialogue existed, with the government (as the centre of policy design and decision-making) presiding over the process of policy formulation. Other actors – Parliament, political parties, business actors, trade unions and civil society groups – either did not demonstrate sufficient proficiency to participate equally and independently in the dialogue or were not consulted on the matter at all. Given the lack of an effective public discussion of the reform, the dialogue was replaced by attempts to communicate the reform through public information/education campaigns.

5. The 2013 pension reform: Major impacts

Fiscal and socioeconomic results of the reform after implementation

The transformation of the Kazakhstani pension system, which began in 1998 and continued with the introduction of the BSP in 2005 and the 2013 pension reform, is an ongoing process. In 2018, the government plans to link the size of the BSP to the length of service/employment and introduce new employers’ contributions equivalent to 5 per cent of employees’ earnings. This pension payment will be available to all citizens with an employment record of no less than five years (Atabaev, 2014). It is still too early to draw any conclusions on the sustainability of the new pension system.

The UPF is currently the only organization responsible for managing pension funds. Although private pension funds are permitted to attract voluntary pension contributions, no licenses to manage voluntary pension funds have been issued to date (National Bank of the Republic of Kazakhstan, 2015). As of September 2015, the UPF reported a slight increase in the number of contributory pension accounts (54,127 accounts or 0.6 per cent) while mandatory occupational pension accounts increased by 32,172 accounts (or 9.8 per cent) (Table 2) (National Bank of the Republic of Kazakhstan, 2015a). Between January and September 2015, the amount in pension funds increased by 656.7 billion tenge (14.6 per cent) in the case of mandatory pension contributions, and 24 billion tenge (91.3 per cent) in the case of mandatory occupational pension contributions. In the case of voluntary pension contributions, the amount of pension funds increased by 0.1 billion tenge (6.7 per cent, Table 3) (National Bank of the Republic of Kazakhstan, 2015a). The pension savings of contributors has increased since the beginning of the year by 680.7 billion tenge (15.1 per cent) and amounted to 5,198.5 billion tenge. Table 4 demonstrates the composition of pension funds. Pension payments also increased by 92.7 billion tenge (17.5 per cent) and amounted to 622.3 billion tenge as of September 1, 2015, up from 529.6 billion tenge in January 2015 (National Bank of the Republic of Kazakhstan, 2015a).

Table 2. Number of accumulative pension fund accounts

	1 January 2015	1 September 2015	Rate of change (per cent)
Mandatory pension	9,377,563	9,431,690	0.6
Voluntary pension	39,934	39,416	- 1.3
Mandatory occupational pension	328,105	360,277	9.8

Source: National Bank of the Republic of Kazakhstan, 2015a.

Table 3. The size of pension funds (in billions of tenge), as of 1 September 2015

Pension funds, in billions of tenge	1 January 2015	1 September 2015	Increase (per cent)
Mandatory pension accounts	4490,0	5146,7	14.6
Voluntary pension accounts	1,5	1,6	6.7
Mandatory occupational pension accounts	26,3	50,3	91.3

Source: National Bank of the Republic of Kazakhstan, 2015a.

Table 4. Composition of pension funds

The amount of pension savings	1 January 2015	1 September 2015	Increase (per cent)
Pension funds, in billions of tenge	4517.8	5198.5	15.1
Pension contributions, in billions of tenge	3686.3	4138.2	12.3
Net investment income, in billions of tenge	990.5	1311.2	32.4
The share of net investment income in the amount of pension savings, per cent	21.9	25.2	3.3

Source: National Bank of the Republic of Kazakhstan, 2015a.

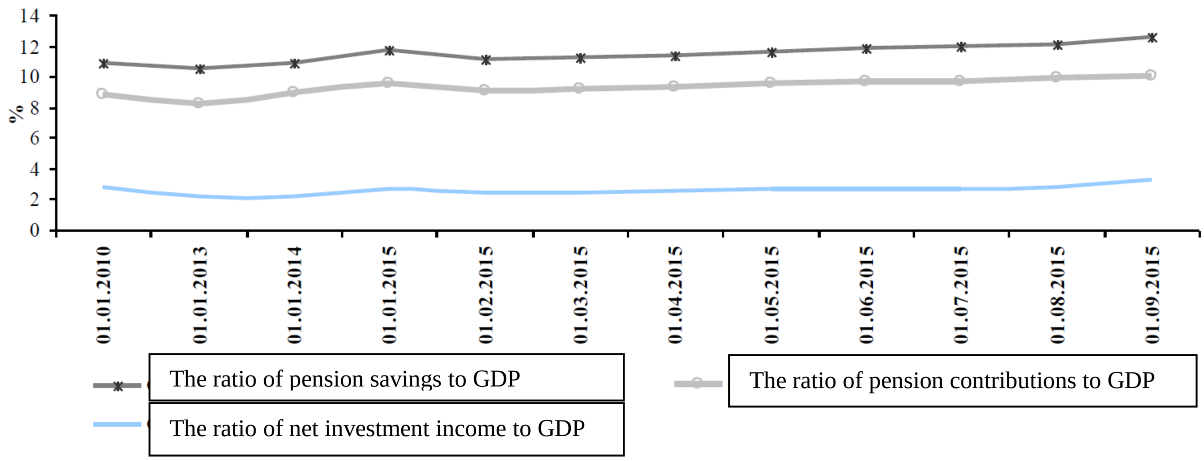
With respect to the performance of the new pension system and its role in the national economy, a recent government report claimed a positive dynamic, although it is still too early to draw final conclusions. Figure 1 shows that since January 2015, the ratio of pension savings to GDP increased from 11.7 to 12.6 per cent, pension contributions to

GDP from 9.5 to 10 per cent, and net investment income from 2.6 to 3.2 per cent (National Bank of the Republic of Kazakhstan, 2015a).

As of 1 September 2015, the major share of the total investment portfolio of the UPF was composed of government securities and corporate securities of the Republic of Kazakhstan: 44.1 per cent and 39.1 per cent, respectively. Foreign bond investments total 317.2 billion tenge (6.4 per cent), including corporate bonds of foreign issuers, securities of international financial organizations and government securities of foreign issuers. Table 5 provides an overview of the investment portfolio of UPF as of September 2015.

As is evident from this brief overview, the investment portfolio of the new pension system has remained conservative and is limited by the underdeveloped domestic stock market. Accordingly, most pension funds are invested in low-risk government securities. However, a closer analysis reveals a slight decline in investments in government securities and an increase in corporate bonds (Shakenova, 2015). As of June 2018, the portfolio distribution was 46 per cent in government securities, 27 per cent in domestic corporate securities, 16 per cent in foreign securities, 10 per cent in bank deposits - and 1 per cent in cash and other receivables.

Figure 1. Impact of the pension sector on Kazakhstan's economic performance



Source: National Bank of the Republic of Kazakhstan, 2015a.

Table 5. Structure of the UPF investment portfolio as of September 2015

Financial instruments	Current cost in billion tenge	Per cent share
Government securities of the Republic of Kazakhstan	2196.7 (1967.3 in Jan 2015)	44.1 (45..3 in Jan 2015)
Government securities of foreign issuers	61.6 (74.3 in Jan 2015)	1.2 (1..7 in Jan 2015)
Securities of international financial organizations	83.6 (82.5 in Jan 2015)	1.7 (1.9 in Jan 2015)
Corporate bonds of issuers of the Republic of Kazakhstan	1947.0 (1364.9 in Jan 2015)	39.1 (31.4 in Jan 2015)
Corporate bonds of foreign issuers	172.0 (151.3 in Jan 2015)	3.5 (3.5 in Jan 2015)
Refined gold	0.0 (0.0 in Jan 2015)	0.0 (0.0 in Jan 2015)
Deposits in second-level banks	519.8 (710.2 in Jan 2015)	10.4 (16.3 in Jan 2015)
Derivatives	0.0 (-4.5 in Jan 2015)	0.0 (-0.1 in Jan 2015)
Total	4980.7 (4346.0 in Jan 2015)	100.0 (100.0 in Jan 2015)

Source: National Bank of the Republic of Kazakhstan, 2015a.
Link: http://www.afn.kz/index.cfm?docid=781&switch=russian.

The centralization of pension funds helped reduce commission fees and operational costs by almost half and is contributing to the greater transparency and accountability of the UPF to its contributors. Prior to the 2013 pension reform, commission fees charged by private PPFA often exceeded 15 per cent of their investment income and 0.05 per cent of pension assets monthly. Following the centralization of pension funds, the government ruled that the UPF could not charge more than 7.5 per cent of the investment income and 0.025 per cent of pension assets monthly. Beginning in 2016, commission fees were further reduced to 5.25 per cent of investment income, and 0.0225 per cent of pension assets monthly (Kursiv.kz, 2013; Association of Financiers of Kazakhstan, 2015a).

Furthermore, besides the underdeveloped stock market, the poor diversification of investment portfolios and contributors' limited control over their pension funds, other issues of concern include the low coverage of the population in the case of the contributory pension system. Although recent trends suggest a slight increase in the number of accountholders, the situation is viewed with concern, especially in light of the forthcoming changes to the BSP in 2017 and 2018. These changes could have a significant impact on the well-being and old-age security of several vulnerable population groups. Low levels of voluntary pension contributions are also worrisome.

Currently, about 66 per cent of the economically active population participates in the contributory pension system, including 98 per cent of formal-sector employees. However, as the Kazakhstani labour market is weakly developed and has a large informal sector, many people are self-employed and/or employed unofficially, and therefore do not contribute to the pension system. According to several sources, more than 30 per cent of the population is not covered by the contributory pension system. This is especially problematic for women, who are more likely to be employed in the agricultural sector or in domestic service.

High levels of self-employment and unemployment explain the low coverage rate. Even many formally-employed workers are contributing minimal amounts, and thus will receive low pensions. By failing to address the problems of workers employed in the informal sector, low-income workers and workers with interrupted employment records, the government is creating a significant problem for itself in the future.

The government has proposed some steps to address the problems facing the current pension system. To increase the participation rate of the self-employed population, especially women, in the contributory pension system, the government is currently working on a new Labour Code, with the goal of formalizing the employment relationship in the informal market and attracting self-employed people to the contributory pension system. The government plans to clarify the status of self-employed workers and to make participation in the pension system mandatory. The order of pension contributions will also be changed to enable self-employed people to disclose information on their real wages and make adequate pension contributions. The forthcoming changes to the BSP are also meant to encourage workers to enter into formal employment relationships with employers since this benefit will soon be available to citizens with an employment record of no less than five years (Atabaev, 2014).

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