

Pension reforms in Central, Eastern and Southern Europe: a comparative overview

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Tine Stanovnik

Faculty of Economics and Institute for Economic Research, Ljubljana

1. Introduction

In the early 1990s, all socialist and communist countries in Europe experienced sweeping changes – political, economic and social. Political – through the introduction of a multi-party parliamentary system; economic – through rapid privatization and movement toward a market economy; social – through large and at times dramatic “downsizing” of the state and state enterprises as the main providers of social welfare.

In terms of expenditures, the pension system has constituted the largest part of the social protection system. In most ex-communist countries of Europe, these systems were under extreme stress during the early 1990s, due to the fall in production, large decrease in employment (and particularly employment in the formal sector), large tax erosion – caused by enterprise restructuring and increase in informal employment. The social protection system responded mainly by diminishing social rights. For pension systems this was most visible through hap-hazard and ad hoc indexation, resulting in large decreases in the relative value of pensions.

2. Pension reforms

After achieving some breathing space and a satisfactory degree of political, economic and social stability, these “transition” countries of Europe started with a general and broad overhaul of their social protection systems, particularly their pension systems. Table 1 shows the years of legislated pension reform in the eight countries of Central, Eastern and Southern Europe (CESE) that will be subject to our analysis. Implementation follows legislation, so that the reforms were in most cases implemented with a one year lag, and in some cases this lag was even greater.

Table 1: Pension reforms in the 1990s and 2000s (year of legislation)

Bulgaria	2000 (first pillar), 2002 (second pillar)
Croatia	1998 (first pillar), 1999 (second pillar)
Czech Republic	1995, 2004, 2008
Hungary	1997, 2006 - 2008
Poland	1999
Romania	2000 (first pillar), 2006 (second pillar)
Slovakia	2003 (first pillar), 2004 (second pillar)
Slovenia	1999

Source: National reports on strategies for social protection and social inclusion 2008-2010, country reports; Holzmann and Guven (2009).

Not counting the Czech Republic, which legislated some parametric changes in its first pillar already in 1995, the “front-runners” were Hungary and Poland. Their pension reforms were widely publicized, also because of the very strong involvement of international organizations (particularly the World Bank) – not only in planning and designing the reform, but also in actual financial support. Most “transition” countries of CESE followed suit, emulating the “paradigmatic shift” initiated by Hungary and Poland. There are two exceptions, two countries that did not join “the pack” and were steering a somewhat independent course of greater gradualism. These two countries – the Czech Republic and Slovenia – also happen to be among the more developed countries of CESE, in terms of economic and social indicators. However, it must be noted that these two countries were strongly criticized by international institutions as laggards in structural reforms. Table 2 gives a snapshot of the pension reforms introduced in the eight CESE countries.

Table 2: Directions of pension reform

	1. pillar	2. pillar
Bulgaria	change to point system	mandatory
Croatia	change to point system	mandatory
Czech Republic	parametric reform	voluntary
Hungary	parametric reform	mandatory
Poland	change to NDC	mandatory
Romania	change to point system	mandatory
Slovakia	change to point system	mandatory
Slovenia	parametric reform	voluntary

Note: According to the World Bank terminology, the second pillar is a mandatory pillar; however we include in the second pillar all pension schemes (mostly occupational) which are strongly linked to the first pillar, i.e. only members of the first pillar can join these schemes.

As seen from Table 2, four countries introduced a point system in their first pension pillar, Poland opted for a more radical change to a NDC system, whereas three countries (Hungary, the Czech republic and Slovenia) introduced “only” parametric changes in the first pension pillar. Of the eight countries, six introduced a mandatory, private and fully funded second pillar. There are quite large differences in the organization and defining characteristics of both the reformed first pillar and the newly introduced mandatory second pillar. However, all the pension systems do share some common features, in that eligibility requirements for pensioning were tightened, actuarial fairness has been improved (there is a tighter link between paid contributions – or past wages – and pensions received) and financial sustainability has been improved. We shall deal with each of these three elements.

2.1 Changing eligibility conditions

By “changing eligibility conditions” we actually mean the tightening of eligibility conditions. Table 3 provides an indicator of this “tightening”, i.e. the statutory retirement age, which has been increasing in all eight CESE countries.

Table 3: Legislated statutory retirement age

	Men	Women
Bulgaria	63	60
Croatia	65	60
Czech republic	65	65
Hungary	65	65
Poland	65	60
Romania	65	60
Slovakia	62	62
Slovenia	63	61

Source: National reports on strategies for social protection and social inclusion 2008-2010, country reports; Holzmann and Guven (2009), Kiss (2009).

Table 3 does not show from what levels these countries have been moving, nor when this legislated retirement age will be achieved. We provide a brief list, by country.

- Bulgaria: the statutory retirement age for men (63) was reached in 2005, for women (60) in 2009.
- Czech republic: the statutory retirement ages for men (65) and women (65) will be reached between 2017 and 2030. However, women with 2 children will be able to retire at 64, with three children at 63, with four and more children at 62.
- Croatia: the statutory retirement ages for men (65) and women (60) were reached in 2008.
- Hungary: the statutory retirement ages for men (62) and women (62) was reached in 2009. Legislation passed in May 2009 will increase the retirement age to 65, by 2022.
- Poland: the statutory retirement ages for men (65) and women (60) were reached in 2007.
- Romania: the statutory retirement ages for men (65) and women (60) will be reached in 2014.
- Slovakia: the statutory retirement age for men (62) was reached in 2006, for women (62) will be reached between 2014 and 2023 (depending on number of children; women with more children will reach the retirement age of 62 later).
- Slovenia: the statutory retirement age for men (63) was reached in 2009, for women (61) will be reached in 2023. Persons with children will be able to retire at a lower age: the reduction (in 2014) will be 7.5 months for one child, 18.75 months for two children 33.75 months for three children and 18.75 months for each additional child.

Again, it must be stressed that the pace of increase – in countries which have not reached the final values yet – is very unequal. In Slovakia, which has abolished lower retirement ages for women with children, the pace is quite fast: increase of 9 months per year, in the Czech Republic the increase in retirement age proceeds at a more glacial pace, i.e. between 2 and 4 months each year. The increase in Slovenia is also slow, as the retirement age for women is increasing by 4 months every year.

Statutory retirement age is not necessarily strongly correlated with effective retirement age. A low effective retirement age might imply that there are numerous possibilities for early retirement – not only through various special schemes for certain occupations, but also through general early retirement provisions and disability schemes. As seen from Table 4, only one country (Bulgaria) offers “in principle” no possibility for early retirement, meaning that this option is not available within the general first pillar pension scheme. There are of course early retirement options for specific occupations – offered in all eight CESE countries.

Bulgaria and Slovenia, for example, provide early retirement pensions for specific occupations within the second pillar.

Table 4: Possibilities for early retirement

	Early retirement possible	Early retirement possible without reductions
Bulgaria	No	No
Croatia	Yes	No
Czech Republic	Yes	No
Hungary	Yes	Yes
Poland	Yes	No
Romania	Yes	No
Slovakia	Yes	No
Slovenia	Yes	Yes

Source: National reports on strategies for social protection and social inclusion 2008-2010, country reports; Holzmann and Guven (2009), Kiss (2009).

The experience of Poland is instructive, showing how political pressure and forces can shape actual developments and seriously offset the intended effects of pension reform. Thus, in 2005 the parliament decided to exclude miners from the new pension system (in addition to farmers and the military service, which were excluded from the very start) and prolong the early retirement option till the end of 2007. Before the parliamentary elections in 2007 this option was further postponed till the end of 2008. It seems that not even this will apply, as the Constitutional court decided that early retirement (for men 60 years old and with an insurance period of 35 years) should be allowed. In addition, even after the deadline, the early retirement pension will *de facto* remain – it will be renamed “bridge” pension. These benefits are to be temporary benefits, financed not from the social insurance fund but by the employer and state budget.

Only Slovenia and Hungary offer the possibility of early retirement without penalties; this is conditional on an insured person fulfilling the criterion of long period of service. Thus, in Slovenia early retirement without penalties is (at present) possible for men who have at least 40 years of work¹ and they can retire from age 58. In Hungary, the requirement is (at present) 40 years of service; men can retire by the age of 60 and women by the age of 59. However, in Hungary this “no penalty” option for early retirement will be abolished by 2013.

Six countries offer the option of early retirement with penalties, i.e. reduction in benefits. The reduction in benefits is permanent, as they remain in place even after a person reaches statutory retirement age. The values of reductions differ widely among countries, though the reduction schedule typically has a simple structure – mostly 1.2%, 1.8%, 3.6% or 6% per year of retirement prior to the statutory retirement age. Slovenia maintains a digressive structure (higher annual penalties for years further from the statutory retirement age). Croatia changed these penalties frequently: 1.33% (per year of early retirement) prior to the 1998 reform, followed by 3.6% up to 2008 and then decreased to 1.8%. The latter decrease was doubtlessly caused by strong pressure from the trade unions.

Most of the CESE countries also offer incentives for retirement past the statutory retirement age. Thus, in Bulgaria, the increase in pension for an additional year was 3%, increasing to 5% from January 2009. In the Czech Republic, Hungary (since 2004) and Slovakia, the increase is 6% per additional year. Slovenia has a quite peculiar – digressive – system, with

¹ Years of work do not include non-contributory periods and periods for which insurance could be purchased *ex post*.

increases varying from 3.6% to 0% (higher accruals for years closer to the statutory retirement age). In Romania, the increase is 3.6% per year, whereas the Croatian pension system does not offer any incentives. In Poland, the question of incentives is rather irrelevant, due to the fact that the public pension system is an NDC system.

2.2 A closer link between contributions (past wages) and pensions

Penalties for early retirement contribute toward actuarial fairness, and thus also provide a tighter link between past wages and pensions received during retirement. Though these penalties are not closely related to actuarial fairness – they are in most cases far too low, they must be viewed as a step in the right direction. There are other important elements of the improved link between contributions (or past wages) and benefits: Table 5 shows how the period relevant for the calculation of pension is being extended to include the whole active working years of the insured person. Typically, the gradual extension means that every calendar year an additional year is taken into account when calculating the pension assessment base. However, the extension for Croatia is more radical, as an additional three years are taken into account every calendar year.

Table 5: Some legislated features of the public pension systems

	Minimum insurance period (years)	Period relevant for calculation of pension	Indexation mechanism
Bulgaria	15	Entire working period (gradually)	Swiss indexation
Croatia	15	Entire working period (gradually)	Swiss indexation
Czech Republic	35	Last 30 years	Price growth + 1/3 of wage growth
Hungary	15	Entire working period (gradually)	Indexation dependant on GDP growth
Poland	None	n.a.	80% price growth + 20% wage growth
Romania	15	Entire working period (gradually)	Not fixed
Slovakia	15	Entire working period (gradually)	Swiss indexation
Slovenia	15	Best 18 years	Wage growth

Source: National reports on strategies for social protection and social inclusion 2008-2010, country reports; Holzmann and Guven (2009).

2.3 Some other important features of pension systems

Without ambition to be exhaustive, we will briefly present two important features of pension systems. These are (1) the guarantee of minimum income for the elderly and (2) the rewarding of noncontributory periods. These two features provide at least a partial “glimpse” of the redistribution present in the general public pension system. There are other features which would provide elements for a more complete assessment of the redistributive nature of public pension systems, such as the significance of special schemes (for the military, farmers, groups of government officials, hazardous occupations etc), the maximum/minimum pension ratio etc. Just as an illustration of the importance of special schemes and provisions: Poland has a large special pension scheme for farmers, receiving massive subsidies from the state budget.

Croatia has a large number of pensioners (mostly Homeland war veterans) who receive (high) pensions according to special provisions etc.

Clearly, the question of minimum income guarantees for the elderly is quite important, and national systems have come up with different solutions. One option is to offer no special minimum income guarantee for the elderly, but to apply the generalized minimum income scheme, available to the whole population. If special minimum income guarantee provisions for the elderly are introduced, these can take several forms: a minimum (“social”) pension and a minimum social insurance pension or an old-age allowance, earmarked specifically for poor pensioners. The minimum pension is available to all persons who have in some way contributed to the pension system. The minimum social insurance pension is available to persons with a sufficient number of years of service. Yet further, the amount of this pension can vary according to the number of years of service.

- Bulgaria has a minimum pension (the so-called social pension) and a minimum social insurance pension. The minimum pension is income-tested and available to persons aged 70 and above.
- Croatia has a minimum social insurance pension, which varies according to years of service. However, this pension is available only for those active insured persons who have remained in the “old” social security system, i.e. do not divert part of their contributions to the mandatory second pillar. Persons who have joined the mandatory second pillar are not eligible for this minimum social insurance pension. There is also a generalized social assistance scheme, available to all persons.
- The Czech republic does not have a specific scheme for the elderly: a generalized scheme for minimum income guarantee applies also to the elderly.
- Hungary has a minimum social insurance pension, available to persons with at least 20 years of insurance. An old-age allowance is also available to persons (and couples) aged 62 and above, whose total income falls below a given percentage of the minimum social insurance pension.
- Poland has a minimum social insurance pension, available to persons who have reached the statutory retirement age and have a minimum insurance period (20 years for women, 25 years for men). For those elderly who do not satisfy the above conditions, there is a generalized social assistance program.
- In Romania, a minimum social insurance pension is set indirectly, by stipulating that the minimum number of pension points in a given year cannot be less than 0.25. A minimum pension is introduced starting in April 2009 – most of the recipients will be agricultural retirees.
- There is no stipulated minimum social insurance pension in Slovakia. However, pensioners for whom the pension received is less than a given percentage of minimum subsistence, are entitled to an old-age allowance.
- Slovenia has a minimum pension, minimum social insurance pension and an old-age allowance (“pension income supplement”). The minimum pension is available mostly to farmers. The old-age allowance is available only to persons receiving a minimum social

insurance pension. The minimum social insurance pension varies according to years of service, the minimum insurance period being 15 years. Finally, a means-tested state pension (quite similar in value to the minimum pension) is granted to persons who are not eligible for any pension (from the Slovene pension system or foreign pension system). Recipients must be at least 65 years old and must have spent at least 30 years in Slovenia.

Table 6 summarizes our findings:

Table 6: Minimum income guarantees for pensioners

	Minimum pension	Minimum social insurance pension	Old-age allowance
Bulgaria	Yes	Yes	no
Croatia	No	Yes	no
Czech republic	No	No	no
Hungary	No	Yes	yes
Poland	No	Yes	yes
Romania	Yes	No	no
Slovakia	No	No	yes
Slovenia	Yes	Yes	yes

Note: See text for additional explanations.

The treatment of non-contributory periods would merit a separate study, as there are quite large differences between these eight countries. As a rule, for non-contributory periods the government pays contributions out of the state budget, so that in fact a person is pension-insured during this period. However, in some countries (notably the Czech republic) the budget of the Social Security Administration takes the burden (and honours these periods). Yet further, several countries offer the option of purchase – *ex post* - of some non-contributory periods; this is done by the insured person.. In assessing one’s entrance pension, years of service and non-contributory periods are taken into account.

The granting of non-contributory periods was particularly generous in the Czech republic, with the inclusion of periods of child-care (for a child up to the age of 4), periods of university study, periods of care for a person who is dependent on the care of another person and period of compulsory military service. On the other end of the spectrum is Slovenia, which honours periods of university study and periods of compulsory military service only as fulfilling conditions for pensioning; these periods have accrual rates 0%, so that they do not increase one’s entry pension. However, an insured person can purchase these years, i.e. pay (ex post) “notional” contributions for these periods, in which case these periods are treated as “normal” insurance periods. Even for periods of child care (and for persons who are not insured as workers or selfemployed) the insurance base (out of which the government pays contributions) is quite low in Slovenia.

Overall, there is a clear desire to reduce or limit the extent of non-contributory periods. For example, Croatia has disallowed the purchase of periods of university study. The Czech Republic has, starting in 2010, decided to strike-out periods of university study; however, it will still honor such periods accrued up to 2010.

2.4 Fiscal sustainability and pension adequacy

We shall not deal with the “meaning” of fiscal sustainability. We though do state the obvious, namely that a pension system which grants low values of pensions and generates low pension expenditures (measured as percentage of GDP) cannot be labeled as “successful” if the share of elderly living in poverty is high.

An important measure aimed at ensuring fiscal sustainability is an indexation mechanism which does not offer full wage indexation. The Swiss indexation (which is equal to 50% of price increase and 50% of wage growth) would therefore pass this test of “acceptability”. As seen from Table 5, three countries – Bulgaria, Croatia and Slovakia - have Swiss indexation of pensions. Hungary applied the Swiss indexation rule up to 2009; starting from 2010, pension indexation will be less favourable, and Swiss indexation will apply only if GDP growth is greater than 5%. For lower GDP growth rates the relative weight of price increase will be greater: thus, for GDP growth less than 3% indexation will be based exclusively on price increase. In Poland the indexation “blend” consists of 80% of price increase and 20% of wage increase. The Czech Republic has a formula which maintains the real value of pensions and also allows pensioners to share in economic growth, thus somewhat increasing the real value of pensions. Romania has a rather unstable indexation mechanism, where pension increase is set within a band of “permissible” values of the pension point. Only Slovenia maintains an indexation mechanism where pensions are indexed to wage growth; however, it is not quite so, as the pension indexation would more correctly be described as wage growth minus 0.6 percentage points².

Pension adequacy is a similarly elusive term. One would be tempted to describe a pension system that offers high replacement rates as “satisfactory” in terms of adequacy. However, a comparison of replacement rates is fraught with difficulties. Using net values is generally more meaningful, as we are comparing purchasing power of pensions relative to wages. Even here serious difficulties arise. Are we including all pensions or only old-age pensions in this comparison? Are only social insurance pensions included in the comparison, or also pensions based on social assistance? That is why one ought to be very “circumspect” in these comparisons. Bearing in mind these caveats, a “tentative” comparison of the pension/wage ratio, using net values, shows that Slovenia still maintains relatively high values (greater than 60%), in spite of the 1999 pension reform; however, these values are clearly on a decreasing trend, as shown in Table 7. Among the eight countries, Slovenia and Hungary probably have the highest ratio - above 60%, the Czech republic and Poland have a ratio of about 55%, followed by Slovakia (about 50%), with Romania and Bulgaria on the lower end of the spectrum, with values of around 40% or even less.

² Due to the economic and financial crisis, pension indexation has been discontinued in 2009 in a number of countries.

Table 7: Replacement rates in Slovenia, 2000 – 2008

	Old age pension (as % of average net wage)	Pension (as % of average net wage)
2000	75.3	68.1
2001	73.2	66.3
2002	72.8	65.9
2003	71.1	64.5
2004	70.2	63.7
2005	69.1	62.7
2006	68.6	62.5
2007	67.1	61.3
2008	67.1	61.6

Source: Monthly statistical bulletin of the Institute for pension and disability insurance, May 2009.

Low values of the pension/wage ratio do not necessarily imply that pensioners live in poverty, as there are numerous coping strategies, such as working in agriculture or other means of gainful employment after retirement. Also, pensioners can live in extended families, sharing income with active members of the household, or they can live in pensioner households, relying only on pensions as a source of income. Table 8 provides a comparison of poverty rates for seven countries (Croatia is not included), showing poverty rates for the total population and for the elderly (60+), split by gender³.

Table 8: Poverty rates (in %) for total population and for population 60+, 2007

	Poverty rates (in %) for total population			Poverty rates (in %) for population 60+		
	Total	M	F	Total	M	F
Bulgaria	14	11	17			
Czech Republic	10	9	10	5	2	7
EU15	17	15	17	20	17	22
Hungary	12	12	12	6	4	7
Poland	17	18	17	8	7	9
Romania	25	24	25	28	24	31
Slovenia	12	10	13	18	10	23
Slovakia	11	10	11	7	4	10

Source: Eurostat

Unlike the core EU countries (EU15), poverty rates among the elderly in the CESE countries are much lower than the poverty rates for the total population – the exceptions are Romania and Slovenia. Also, as a rule, poverty rates for elderly women are much higher than for men – this is mainly due to the fact that many women receive a small widows' pension and live in single person households.

³ Poverty rates are set at 60% of median equalized income.

3. Some reflections on the reform of the public pension pillar (first pillar)

We have already observed that four of the CESE countries have moved to a point system. In the point system, the entry pension is computed as:

$$\text{Pension} = \text{AVGP} \cdot \text{YS} \cdot \text{VPP}$$

Where:

AVGP = average number of pension points per year of service

YS = years of service

VPP = value of pension point.

The average number of pension points per year of service is typically computed using a given service period; we have seen that this period is gradually moving toward the complete working period. The number of pension points⁴ for a given year (used in calculating this average) is capped, and in some cases a floor is also set (so that this number in a given year cannot be less than a given value). The four countries which adopted the point system have been quite resourceful in applying the point system, using variants of the basic formula described above. Romania uses different values of the pension point with regard to gender (the values for women are somewhat higher).

The value of the pension point is usually specified as a given percentage of average nationwide wage (frequently, in the year preceding the retirement year)⁵. These values are in the range between 1% and 1.25% of the average nationwide monthly wage, so that a person whose average number of pension points per year of service was 1 and with 40 years of service would receive a pension equal to 40%-50% of the average national wage. In effect, setting the value of the pension point equal to a fixed percent of average nationwide wage means that in forming the “pension assessment base”, wages are valorized using the growth of average wages.

The switch to a point system from a “classical” Bismarckian pension system might not be straightforward in all cases. This is particularly valid if the inclusion of wages in the pension assessment base under the current public pension pillar is digressive, or if the accrual rates are digressive.

Example 1:

In forming the pension assessment base in the Czech Republic, 100% of income up to approximately 43.2% of average gross wage is included, only 30% of the income between 43.2% and 107% of average gross income and only 10% of income exceeding 107% of average gross income.

⁴ A person who in a given year receives the average nationwide wage is granted 1 pension point for that year; if he receives twice the average nationwide wage, he receives two pension points etc.

⁵ However, there is variety! Romania specifies a value of the pension point for the full insurance period, giving a value of about 42 % of average nationwide gross wage for 34 (men) and 29 (women) years for service; this was valid in 2009. Croatia does not set the value of the pension point with regard to the nationwide wage, but has been uprating this value using the Swiss indexation. This in effect means that wages are valorised using the Swiss formula.

Example 2:

The accrual rates (for women) in the Slovene pension system are: 38% for first 15 years, followed by 1.5% per year for each additional year of insurance. This means that the accrual rate per year for the first 15 years is 2.53%, followed by 1.5%.

Example 3:

Hungary had both digressions: in the forming of the pension assessment base and in the accrual rates. The first digression is to be abolished by 2009, the second by 2013, when the accrual rate will be uniform, i.e. 1.65 percent (for those remaining only in the first public pillar).

From these examples, one might infer that a transformation from a “classical” Bismarckian first pillar (based on pension assessment bases and accrual rates) to a point system would be the simplest for Hungary (by 2013), followed by Slovenia. The current public pension system in the Czech Republic does not allow for a smooth transformation to a point system. Namely, digressions in the formation of the pension assessment base and accrual rates are strong instruments of redistribution, and the point system eliminates these “avenues” of redistribution, though it does not eliminate redistribution altogether. Redistribution is possible by setting a ceiling and floor on the average value of pension points per year of service.

4. Some reflections on the mandatory second pillar

We have seen that six countries of our CESE group have opted for a mandatory, private fully-funded second pillar. “The jury is still out” to pronounce a verdict on the overall success of the mandatory second pillar. Though the financial performance of pension funds has been improving, with greater diversification of their investment portfolio, the 2008-2009 financial and economic crisis has dealt a very severe blow. In some countries there were serious implementation flaws, as well as flaws in design.

The technical problems which Poland experienced, caused by the individualization of contribution payments and contribution records, are well documented. It took some time for the IT applications to become fully operational. Hungary sets a vivid example of what can go wrong if the reform is not well designed; being a front-runner, the followers were careful not to repeat some of the design faults and implementation rules. The wrong decisions taken concern mainly two issues:

1. who will collect contributions for the 2. pillar?
2. switching rules, i.e. who will be able to join the mixed system (i.e. enroll in a second pillar pension schemes and redirect part of the individual’s pension contribution to the second pillar);

Hungary decided that the second pillar mandatory contributions would go directly to the pension funds, thus depriving the relevant state institutions of control of contribution collection for the second pillar. This – predictably – also caused serious record-keeping problems in the first years of implementation.

With regard to the second issue, i.e. possibilities of inclusion into the mixed system, Hungary offered the option wide open to all employees, who had 20 months time to decide whether to remain in the first pillar only or to join the mixed system⁶. For new entrants in the labour market there was no alternative and membership in the mixed system was mandatory. The

⁶ This option was open from January 1, 1998 to August 31, 1999.

massive enrolment into the mixed system by far exceeded expectations; consequent to this “stampede”, Hungarian experts estimated that about 20% of the total membership had no rational financial reasons to join the mixed system, as they would lose much more by partially abandoning the first pillar (and thus surrendering pension rights from the first pillar) than by joining the mixed system (and thus receiving annuities based on pension contributions to this pillar). After such a large part of the active population made such a bad choice, there was intense pressure to allow at least those workers who voluntarily decided to join the mixed system to opt out and return fully to the first pension pillar, if they so wished. Since 2000, there were a number of specific “openings”, enabling certain groups (and age cohorts) to move out of the mixed system.

Other countries took note and imposed (age) restrictions for joining the mixed system or anticipated in advance the possibility to switch back to the “old” system. For example, Croatia set the following rule for enrolment in the mixed system (first and second pillar): mandatory enrolment for employees below age 40 (as of July 2000), voluntary enrolment for employees between age 40 and 50 (as of July 2000). The decision of the 40-50 age cohort had to be made by June 2002 and was irrevocable. Slovakia placed no restrictions on enrolment in the mixed system, but offered a temporary opt-out (and also opt-in!) possibility between January and June 2008: 6.6% of members left the mixed system and moved back to the “old” system. In order to increase flexibility, in Slovakia (starting from 2008) new entrants were offered six months in which to decide whether their mandatory participation will change to voluntary.

Part of the learning process was greater fairness in calculating first pillar pensions for persons moving to the mixed system⁷. Again, countries that introduced a mandatory second pillar did not copy a feature of the Hungarian reform, where persons joining the mixed system (i.e. diverting part of their contributions to the mandatory second pillar) were also forced to surrender some 26% of their accrued rights from the public pension system. In other words, countries which introduced a mandatory second pillar at a latter stage took care that the pension from the first (public) pillar would not entail lower accrued rights from this pillar, up to the point of entry in the mixed system. While avoiding this “error”, some countries could not resist the temptation to introduce other inequities. Thus, Croatia introduced a fairly generous minimum social insurance pension, available only for insured persons that have remain in full social security, i.e. have not joined the mixed system.

Countries that introduced mandatory second pillar pension schemes did not repeat the “liberal” model of contribution collection for the second pillar, as practiced by Hungary. Most countries authorized their tax authorities for collection of these contributions. In Poland, the second pillar contributions are collected by the social insurance institution (ZUS), whereas in Croatia a new institution was formed (REGOS), to deal exclusively with collection of second pillar contributions, distribution of these contributions to pension funds and record-keeping. Tensions between the Tax administration and REGOS developed, so that REGOS had to cede the contribution collection function to the Tax administration. Even Hungary quickly abandoned the “liberal” model (already in 1999), so that second pillar contributions are collected by the Tax administration and then passed on to the accounts of pension funds.

⁷ In Hungary, the loss of first pillar pension rights for persons moving into the mixed system was considerable.

As seen from Table 9, most countries with mandatory second pillar pension schemes now devote a sizeable share of total pension contributions to the second pillar. The only exception is Romania, which introduced its mandatory second pillar recently, with the contribution rate to be increased to 2.5% in 2009⁸.

Table 9: Contribution rates for pension insurance (in %)

	1. pillar	2. pillar	Total
Bulgaria	18	5	23
Croatia	15	5	20
Czech Republic	28	-	28
Hungary	25.5	8	33.5
Poland	12.22	7.30	19.52
Romania	27.75	2	29.75
Slovakia	9	9	18
Slovenia	24.35	-	24.35

Source: National reports on strategies for social protection and social inclusion 2008-2010, country reports; Holzmann and Guven (2009).

Note: Poland and Slovakia have separate contribution rates for disability insurance

In spite of various problems with regard to mandatory second pillar pensions schemes in CESE countries, the mandatory private pillar seems to be “here to stay”. There are still some important issues which will have to be resolved, such as regulating the annuity phase, further decreasing the asset management costs of second pillar schemes and improving the regulatory framework.

How did the voluntary second pillar pension schemes⁹ fare in the Czech Republic and Slovenia? Though these pension schemes have large coverage – they cover close to 60 percent of the workforce in the Czech Republic and in Slovenia, the contribution collected are small. In 2007, the assets of the pension fund amounted to 4.7% of GDP in the Czech Republic and 3.9% of GDP in Slovenia. This might appear surprising, considering that these schemes are strongly subsidized by the government in the Czech Republic, and that for some groups of employees in Slovenia (government employees, employees working in occupations that are granted special early retirement options) these schemes are mandatory. Even for these mandatory schemes the amount of pension wealth per employee is small. In the closed government employee pension fund the amount per member was some 1,500 EUR in 2008, whereas in the closed pension fund covering certain groups of occupations the amounts are somewhat larger – 5,300 EUR per member in 2008.

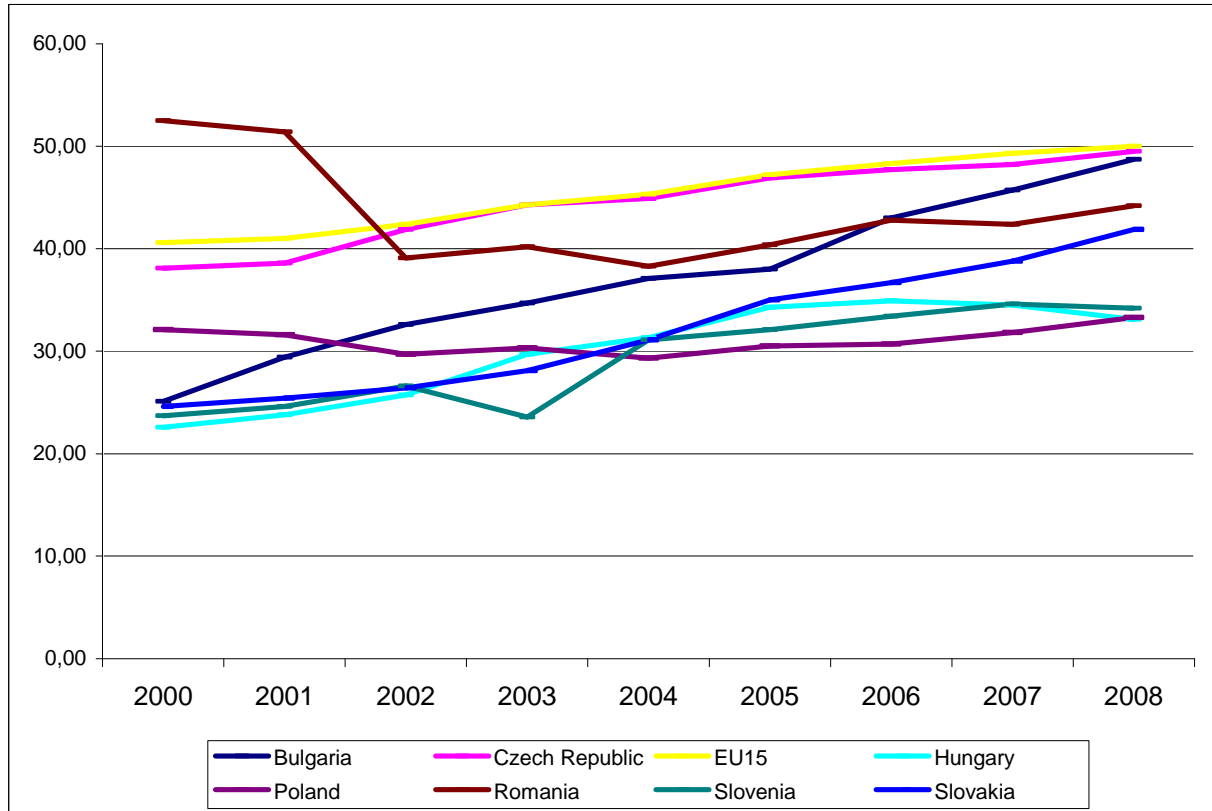
5. Has employment in the elderly age group increased?

An important rationale for pension reforms was to improve the fiscal sustainability of pension systems, not only through the direct negative impact on pensions – decreasing their relative value as compared to wages, but also through the positive impact of increasing activity of the elderly. Figure 1 shows activity rates of the “critical” 55-64 age group in the period 2000 to 2008.

⁸ The contribution rates in Romania have experienced several changes in the past years, the most recent being in 2009, with the total pension contribution rate in 2009 being 31.3%.

⁹ In the terminology of the World Bank, voluntary second pillar pension schemes would constitute the third pillar.

Figure 1: Employment rates in the age group 55-64 years, 2000-2008



The dynamics of employment rates is quite different among countries, with the Czech republic, Slovakia and Bulgaria posting large increases in the 2000-2008 period. In spite of a “big-bang” pension reform in 1999, employment rates of the elderly population in Poland have hardly budged. Similarly low levels are also seen in Hungary and Slovenia. Clearly, there are a number of exit routes from the labour market, possibly also because of the functioning of the labour market, which discourages people to remain active. Increasing activity in this age group remains an important policy goal.

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