

**Recent Trends in Pension Reform
and Implementation
in the EU Accession Countries**

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Introduction¹

Each worker who enters covered employment soon makes a first contribution to the social security administration of his or her country. He or she does so in virtual ignorance of all the events that lie ahead. Then typically, many years later, those who escape death and disability begin to draw a retirement pension. After some additional years, the worker, or a survivor, draws the last payment that the retirement scheme allows. In the course of the 50 or more years that may elapse from first to last of these events, the worker will see his income rise and fall in response to countless unforeseen risks. The worker will witness interest rates alternately reach new lows and new highs, uncharted fluctuations in share prices, boom and recession, spells of unemployment, natural disasters, armed conflicts, changes of political regimes, and fluctuations in what the currency will buy. And finally, at retirement the worker will not know how many more years he or she must plan to rely on a pension.

A fundamental question that must be addressed in the design of all pension schemes is how the risks associated with these uncertainties should be distributed. Who should bear them and how?

Pension policy debates have long revolved around this question. Among the various models and arguments used to defend them, two quite distinct approaches can be discerned. Under the first, the worker receives a pension that results from the pooling of risks and contributions across the covered work force, a sharing that allows all workers to protect themselves to some extent against loss of earnings resulting from the various risks. Under the second approach, the level of protection afforded each worker corresponds closely to his or her own contributions to the pension system. There is little or no sharing of risk or reduction of uncertainty.

The principle of sharing risk is usually translated into pension policy by a legal statute defining a benefit in relation to a worker's earnings. This benefit is typically set to fall within a range that satisfies the demand for a decent minimum while providing enough variation to reward talent and effort. Such systems are thus labeled defined benefit (DB) schemes. They are defined in the sense that for a given level and pattern of earnings, it is possible to know in advance what one's pension will be.

Such schemes are commonly, but not necessarily, administered by government and financed on a pay-as-you-go basis, so that current workers' contributions are used to pay current pensioners and those workers in turn earn the right to be so supported when they reach retirement.

Under such risk sharing arrangements, the benefit is not directly linked to the contribution paid: some workers will receive more than they contributed (e.g., a person who becomes disabled early in his or her career) and others will receive less (e.g., a single worker who dies just after retirement); but what every worker receives is reasonable assurance of a predictable benefit throughout disability or old age and similar protection for his/her dependents. If economic or demographic changes create obstacles to complying with this assurance, it is renegotiated through the political process and adjustments are made in benefits, contribution rates, or both, typically well in advance of their effective date. In this way, risks associated with the

uncertainties in the scheme's operating environment are shared broadly by society, including government, employers, workers, and pensioners.

Under the second model, a worker receives a pension that reflects only his or her own contributions and the losses or gains through interest and other financial returns that they will have attracted in the course of accumulation. There is no benefit formula and the pension paid takes no account of the risks just mentioned. The only smoothing that occurs is for different actual longevities. This type of system maintains an accounting of the year-by-year performance of the worker's personal accumulation as invested. This arrangement seems conceptually simple but in fact requires extensive bookkeeping.

The second model is commonly, but not necessarily, managed by a number of private, and possibly competing enterprises, which hold and invest the worker's contributions and maintain an account of the performance of his or her personal portfolio. At retirement, the worker must use the assets from the portfolio to buy an annuity which will provide the worker with regular benefit payments for the remainder of his or her life. This second type is variously referred to as "privatized," "advance funded," or as "individual savings accounts." Its core is a lack of shared risk, a move to personalize most of the above risks to the individual worker and to commercialize the management of the worker's portfolio and the provision of annuities to private firms.

The current controversy over these two general models was sparked in 1994 by a major World Bank publication, *Averting the Old Age Crisis*, that focused attention on the demographic challenge to the world's pension systems posed by aging populations. This analysis suggested that shifting pension design from the first model to the second could avoid a pension financing crisis as populations age. Since then, the controversy has shaped pension policy discussions worldwide, most markedly in Latin America but also in Europe, Africa, and Central Asia. Most economists and analysts have since abandoned the study's basic claim, and the substance of the debate has shifted to other ground.² Still attention to the controversy between models dramatized by the study has continued. Nowhere has this controversy been more dominant and sustained than in the EU accession countries, roughly half of which have either implemented the second model or are now considering legislation to do so.

With this controversy as a backdrop, this paper will trace recent trends in pension policy in the EU accession countries. Part I provides an overview of changes undertaken since the mid 1990s. It describes the modification of social insurance schemes; the scaling down of these schemes in favor of new arrangements that eliminate the sharing of risk and transfer the management of worker contributions to commercial firms; and the establishment of new mechanisms and incentives for voluntary private pension supplementation. Part II highlights additional pension issues that are in need of attention but have been overshadowed to greater or lesser extents by the controversy between models.

The ILO has tracked the changes in the region's social security schemes over the period under analysis, and the following discussion draws in part on that experience. More particularly it draws on work now in progress at ILO Budapest

supported by the French government. This work involves both research and technical cooperation that aim at strengthening social security in the EU accession countries. The studies undertaken as part of that project examine old age pension reform, disability pension reform, the gender dimensions of social security reform, and efforts to use social security to combat poverty and social exclusion in selected countries. In analyzing pension reform in the Mediterranean countries, the following analysis draws on sources within the ILO as well as from the European Commission, the respective governments, and national analysts.

I. Recent experience with pension reform: a regional overview

Since the mid 1990s, the accession countries have variously combined three sorts of modifications to their pension schemes. The first of these adjusts the parameters of existing social insurance systems. The second scales down social insurance in favor of individual savings arrangements. The third encourages new options for voluntary retirement savings. The particular mix of these policies varies greatly from country to country, as does the pace of action. Some countries now have several years of experience with reforms that transform their systems in fundamental ways, while others are adapting their systems gradually and incrementally.

Countries have made significant adjustments to such features of their public social insurance schemes as retirement age, benefit formulas, the treatment of special categories of workers, and the collection of pension contributions. As can be seen from Table 1, increases in retirement age enacted by most countries range from two to three years for men and from three to six years for women. Most of these are the result of political compromise, with governments having proposed larger increases initially, to be reduced through a process of negotiation with trade unions and, in some cases, with employers. In some countries (e.g., Poland, Slovenia), initial proposals to equalize the retirement age of men and women were rejected in favor of a continuing differential.

Countries have differed in their approach to revising benefit formulas. In many cases the thrust of change has been to eliminate shared risk as an element of pension design, that is, to make pensions more individualized and earnings-related. The largest steps in this direction were taken in Latvia and Poland, both of whom replaced defined benefit schemes with so-called notional defined contribution systems. Here a worker's benefit level is set at retirement entirely on the basis of his or her own record of lifetime contributions and the life expectancy of his or her age cohort at the standard retirement age.³ This eliminates redistribution toward low-income workers and causes benefits to fall (or rise) automatically in response to changes in longevity, unless an individual opts to work a longer (shorter) period. Other accession countries retained their existing defined benefit systems but lowered pension accrual rates for each year of work (Slovenia) or reduced redistribution toward low-income workers (Hungary).

A few countries adopted benefit formula changes that increased redistribution toward low-income workers: Cyprus increased minimum pensions, the Czech Republic adopted a two-tier benefit formula with redistribution toward low-income

workers in both tiers, and Slovenia decreased the difference between the lowest and highest pensions that can be paid to persons with similar years of earnings.

A large majority of countries also increased the number of years of work that are counted in computing a pension, a change that strengthens the relationship between benefits and lifetime earnings intended to encourage longer participation in the formal labour market.⁴

Table 1. Retirement Ages in EU Accession Countries

	<i>Current law</i>	<i>Men</i>	<i>Women</i>
Bulgaria	2000	increasing to 63 in 2005 by 6 months/year	Increasing to 60 in 2009 by 6 months/year
Cyprus	1995	65 (early retirement at age 63)	65 (63 for those born before 1/1/1935)
Czech Republic	1995	increasing to 62 by 2006 by 2 months/year	Increasing to 57-61 (depending on number of children raised) by 4 months/year
Estonia	1998, in force 2000	63	Increasing to 63 in 2016 by 6 months/year
Hungary	1996	increasing to 62 in 2001 by 1 year every second year	Increasing to 62 in 2009 by 1 year every second year
Latvia	1998	increasing to 62 in 2003 by 6 months/year	Increasing to 62 in 2008 by 6 months/year
Lithuania	1994, 2000	increasing to 62.5 in 2003 by 6 months/year	Increasing to 60 in 2006 by 6 months/year
Malta	1987	61	60
Poland	1998 (in force, 1999)	65, with early retirement eliminated beginning in 2007 ¹⁾	60, with early retirement eliminated beginning in 2007 ¹⁾
Romania	2000	increasing to 65 in 2015 by 1 month/quarter	Increasing to 60 in 2015 by 1 month/quarter
Slovak Republic	1988 ²⁾	60	53-57 (depending on number of children raised)
Slovenia	1999	63 ³⁾	61
Turkey	1999	60	58

¹⁾ Elimination of early retirement applies to those covered by the new system, i.e., those born after 1948. There will be exceptions for a narrow list of occupations, to be specified in future regulations. These pensions will be separately financed, not through the social insurance system.

²⁾ A new act is under preparation by the Ministry of Labour, Social Affairs, and Family that will increase the retirement age gradually to 62 for both men and women.

³⁾ Retirement prior to the age of 63 for men and 61 for women entails penalties (this is a general rule, but there are exceptions for certain groups of insured persons). It is also possible to receive bonuses (i.e. higher accrual rates) if the working period is greater than 40 years for men, or 38 years for women.

Among the former socialist countries, some governments have standardized the rules for computing benefits across workers, eliminating previous pension privileges for particular groups – e.g., higher benefits or lower retirement ages for work

categories that former governments had considered of strategic importance. Some countries eliminated such privileges outright (e.g., the Czech Republic, Lithuania); others financed them separately (e.g., Slovenia); and in still others (e.g., Estonia, Poland, the Slovak Republic), the issue of pension privileges remains on the national policy agenda.⁵

Efforts to improve the collection of contributions have focused mainly on the adoption of so-called unified collection systems. Here a single enforcement agency collects contributions to fund several social insurance schemes (e.g., pensions, health care, unemployment, sickness, employment injury) and may collect income taxes as well. This approach can achieve economies of scale in enforcement and gives the enforcement agency access to information on enterprises from multiple government sources. Unified systems are of limited use, however, in reaching the self-employed workers and those in the informal economy for whom no government agency has identifying records. In addition, they divide responsibilities in ways that may create difficulties in administering pensions.⁶ Unified collection systems have been established in Latvia (1996), Slovenia (1996), Estonia (1999), Hungary (1999), and Bulgaria (2002). Romania has adopted a law requiring unified collections, effective in 2004. In the Slovak Republic, a proposal for unified collections has been under consideration for several years.

Bulgaria has recently taken an additional initiative to combat contribution evasion and underreporting of wages by creating minimum contribution thresholds for certain categories of employment and requiring registration of all employment contracts with the social security institution.⁷

The second broad category of modifications moves toward the second model in the pension controversy, that is, in the direction of scaling down the social insurance system and redirecting a portion of pension contributions to mandatory, commercially managed individual savings accounts. This approach differs from that adopted in some Latin American countries where social insurance schemes were *fully* replaced by private individual retirement accounts (e.g., Chile). Among the accession countries, the effort has been rather to structure *mixed* systems under which future retirees will receive benefits through two channels, a private one alongside the public one. In the private component, there is no pooling of risks or savings until retirement at which point an individual's accumulated assets must be used to purchase a lifetime annuity. Workers are usually given a choice among funds management firms and the right to transfer their account from one firm to another. This arrangement effectively shifts risk from society at large to individual workers and shifts the role of government from that of benefit provider to that of regulator vis-à-vis the firms that make up the private tier.

Such reforms have been adopted in Hungary (1998), Poland (1999), Bulgaria (2000), Latvia (2001), and Estonia (2002). Similar arrangements have been proposed by the new government in the Slovak Republic, and in Malta, by a special welfare reform commission. In Lithuania, the government adopted a hybrid approach (2002) in which participation in a private individual scheme is voluntary for all workers but financed by contributions diverted from the public social insurance scheme for workers who choose this option. Several other countries have debated proposals along these lines but declined to adopt them (the Czech Republic, Romania, and Slovenia),

while others have not given this approach serious consideration (Cyprus, Turkey). The current configuration of policy choices is summarized in Table 2.

Table 2. Status of Pension Privatization in EU Accession Countries

<i>Countries with mandatory, commercially managed individual savings accounts</i>	<i>Countries without such schemes</i>
Hungary (1998)	Cyprus
Poland (1999)	Czech Republic
Latvia (2001)	Lithuania ⁽¹⁾
Estonia (2002)	Malta ⁽²⁾
Bulgaria (2002)	Romania
	Slovak Republic ⁽³⁾
	Slovenia
	Turkey

⁽¹⁾ Voluntary second tier financed by contributions from the public pension system.

⁽²⁾ Partial privatization proposed by special welfare reform commission.

⁽³⁾ Partial privatization is under development by the new Government.

Transitional financing costs are important in considering a move in this policy direction. These costs result from the dual needs to build up the individual savings accounts while continuing to honor the benefit obligations of the existing pay-as-you-go scheme. These requirements will pose a fiscal burden for several decades in the range of 0.5-2.5 percent of GDP per year. Covering these costs involves specific problems in the accession countries, since most are operating under political constraints that prohibit increases in contributions. These constraints derive from the current rates, which are high by international standards. (See Table 3.)

**Table 3. Pension contribution rates in EU applicant countries, 2002
(as a percent of insured wages)**

	<i>Employers</i>	<i>Employees</i>	<i>State</i>	<i>Total</i>
Bulgaria	21.75 ¹⁾	7.25 ¹⁾		29 ¹⁾
Cyprus	6.3	6.3	4	16.6 ²⁾
Czech Republic	19.5	6.5		26
Estonia	20	23 ³⁾		22 ⁴⁾
Hungary	18	8		26 ⁵⁾
Latvia	--	--	27.10 ⁶⁾	30.86 ⁷⁾
Lithuania	22.5	2.5		25
Malta	10	10	10	30
Poland	16.26	16.26		32.52
Romania	23 ⁸⁾	12		depends on employer rate
Slovak Republic	21.6	6.4		28
Slovenia	8.85	15.5		24.35
Turkey	11-13 ⁹⁾	9		20-22

¹⁾ These rates apply for normal working conditions and for persons born before January 1, 1960. For persons born after that date, the contribution rates are: 20.25% (employers), 6.75% (employees), 27% (total). For arduous and very arduous working conditions, the contribution rates are: (i) for persons born before January 1, 1960: 24.75% (employers), 7.25%

(employees), 32% (total); (ii) for persons born on or after January 1, 1960: 23.25% (employers), 6.75% (employees), 30% (total).

²⁾ This figure covers all contingencies. There is no legal allocation of contributions between short- and long-term benefits except for unemployment benefits, for which 0.996% (6% of 16.6%) is allocated.

³⁾ 2% employees contribution for funded second tier is compulsory for new entrants to the labour market (persons born 1983 or later) and optional for the current work force.

⁴⁾ For those who haven't joined the second tier, the total contribution rate for pensions is 20%.

⁵⁾ In 2003, the rates are 18 percent for employers and 8.5 percent for employees for a total of 26.5 percent.

⁶⁾ First tier pensions are covered by the state social insurance budget, as are old age pensions granted before the 1996 reform.

⁷⁾ Includes 3.76% for disability (with no distribution to employer and employee). In 2003, the overall social insurance contribution rate is 33.09%. It covers both short- and long-term benefits. 24.09% paid by employers (including 0.09% for employment injury) and 9% by employees.

⁸⁾ 23% for normal working conditions, for arduous and very arduous working conditions, rates are 28% and 33%, respectively.

⁹⁾ Varies based on the work sector (higher for more arduous working conditions).

Given this constraint, most countries that have opted for this approach are meeting transitional costs by increased public borrowing or by so-called internal financing, i.e., by cutting public pension benefits.⁸ Some others, in anticipation of high transitional financing costs, have chosen to phase the private tier in gradually. (See Table 4.)

Table 4. Pension contribution rates in accession countries with mandatory private pension tiers, 2002

Country	Total			PAYGO (1 st tier)			Funded (2 nd tier)
	<i>Sum</i>	<i>Employer</i>	<i>employee</i>	<i>sum</i>	<i>employer</i>	<i>employee</i>	
Bulgaria	29.00	21.75	7.25	27.00 ¹⁾	20.25	6.75	2.00 ¹⁾
Estonia	22.00	20.00	2.00 ²⁾	16.00 ³⁾	16.00 ³⁾		4.00 + 2.00 ²⁾
Hungary	26.00	18.00	8.00	20.00	18.00	2.00	6.00 ⁴⁾
Latvia	30.86	--	--	--	--	--	2.00 ⁵⁾
Poland	32.52	16.26	16.26	25.22	16.26	8.84	7.30

¹⁾The 2% for the second tier is obligatory for persons born on or after January 1, 1960. Persons born before that date do not participate in the funded tier and contribute 29% for the first tier. The allocation of contributions between the first and second tiers is determined each year in the annual budget law.

²⁾An additional contribution (2%) is compulsory for new entrants to the labour market (persons born in 1983 or later) and optional for the current work force.

³⁾For persons who have not joined the second pillar, the contribution rate for first pillar pensions is 20%. For persons who have joined the second pillar, 4 percentage points of the social tax of the employer is channeled to the funded scheme.

⁴⁾ In 2003, this contribution rate increased 6-7%. The total rate increased to 26.5%, which includes 18 % for employers and 8.5% for employees.

⁵⁾ Contributions to the second tier are scheduled to rise to 4% in 2007, 8% in 2008, 9% in 2009, and 10% in 2010.

ILO studies of Hungary and Poland, the countries in the region that have pioneered this model, point to further prerequisites for the success of this type of reform.⁹ These countries' experience can be of great benefit to others planning, implementing or debating similar changes. First, and perhaps most important, this experience shows that there is a need to control private administrative costs, which

have contributed to losses in worker's privately managed savings, that is, to negative real returns in both countries.¹⁰ Second, individual accounts require extensive bookkeeping systems to record the exact amount of every contribution made on behalf of every worker on a monthly basis. This again is a costly and administratively challenging task that neither government has been able as yet to fully achieve. Third, systems of individual accounts intended to provide retirement benefits operate on quite different principles from other benefit schemes. The new accounts must in all cases be integrated with other benefits -- disability and survivors pensions -- in ways that avoid shifting the costs of retirement benefits to these other programs and causing unintended losses and windfalls. Finally, it is important to plan in advance all features of a system and to provide genuine public education so that workers who face a one-time choice of whether to join the mixed system can make this choice with knowledge of all rules under which the new individual savings systems will operate. In both countries, the heavy demands of getting the new individual accounts up and running led the governments to defer some of these issues.

Voluntary supplemental pension plans are the third broad category of change. These are intended to encourage workers to play a greater role in financing their own retirement and thus to bring additional resources to bear for pensions as populations age.¹¹ Enthusiasm for voluntary pension savings has been high among the former socialist countries. The earliest laws were passed in Hungary and the Czech Republic (1994) and then in the Slovak Republic (1996). Since then, all but one have followed suit. (See Table 5.) In addition, Turkey is pursuing the development of voluntary schemes as its next major step, while in Malta, voluntary supplemental plans have been proposed as part of a three-tier pension system. In Cyprus, voluntary saving takes place largely through provident funds, which make lump-sum payments at retirement.

Early experience suggests, unsurprisingly, that the major challenges of building voluntary schemes are attracting younger workers and those with lower incomes, encouraging them to save significant amounts, and inducing employers to contribute to supplemental pension coverage. Slow economic growth has worked against the proliferation of voluntary schemes in some accession countries (e.g., Poland and the Slovak Republic), while in others small populations and undeveloped financial markets have discouraged private companies from starting funds (e.g., Lithuania). In some countries, tax incentives for voluntary savings have proven effective, though costly, in encouraging their development.

In the accession countries, voluntary schemes have been variously designed as individual savings accounts, mutual funds, and occupational pensions. High administrative costs of individual accounts have led some governments to promote occupational arrangements in which employers contribute to the scheme and oversee its operation (e.g., the Czech Republic and Romania). In many countries such arrangements have proven to have stronger management and higher yields than individual savings schemes in which employers play no role. Moreover, such schemes add to the bundle of conditions subject to collective bargaining and thus may help improve benefits and extend coverage. In addition, occupational pensions often feature forms of governance that allow workers and employers to manage the schemes jointly.

Table 5. Laws Authorizing Voluntary Pension Funds in EU Accession Countries

<i>Country</i>	<i>Start year</i>
Bulgaria	1996
Cyprus	-- 1)
Czech Republic	1994
Estonia	1998
Hungary	1994
Latvia	1998
Lithuania	2000 ²⁾
Malta	-- 3)
Poland	1999
Romania	-- 4)
Slovenia	2000 ⁵⁾
Slovak Republic	1996
Turkey	2001

1) Private supplemental coverage is provided by provident funds which make lump sum payments. A law regulating provident funds was enacted in 1981. In addition, Cyprus has *mandatory* supplemental schemes for public employees and employees of certain parastatal companies.

2) However, no pension funds have yet been established in Lithuania. Some pensions are provided by life insurance companies and are not regulated by the new law.

3) Occupational pensions were terminated in 1979. A proposal is under consideration for a three-tier system, including voluntary supplemental schemes.

4) Occupational pensions proposed by government and currently under consideration.

5) The second tier law was enacted in 1992 but without tax relief. The 2000 law, which provides tax relief for pension savings, takes precedence over the earlier law. For a small number of workers (those in heavy and hazardous industries), contributions to supplemental pensions are mandatory for employers.

Source: CEE countries: International Network of Pension Regulators and Supervisors, "Regulation of Pension Fund Investment in CEE Countries" 12 December 2002. Information for Mediterranean countries from the respective labour ministries.

Looking across countries at the distribution of these three categories, we can discern two general strategies that correspond roughly to the terms of the controversy described earlier. One group of countries is scaling down public, pay-as-you-go schemes and putting in place alongside them commercially managed individual savings schemes (Hungary, Poland, Bulgaria, Latvia, Estonia). A second group, including the Czech Republic, Slovenia, Turkey, and Romania, is combining adjustments in their public pension systems with the development of voluntary supplemental retirement schemes.¹² In brief --

- The Czech Republic enacted a law authorizing voluntary private pension funds in 1994 and in the course of the 1990s passed a series of 13 modifications to its public pension scheme. Among these, a 1995 law increased the retirement age, established a new benefit formula, and increased the number of years of work counted for pension purposes. Half the Czech work force now participates in a voluntary supplemental scheme.
- Slovenia enacted major changes in 1999 that increased the retirement age for women, created a new system of rewards and penalties for late and early retirement respectively, reduced wage replacement rates, increased redistribution, and provided authority and tax incentives for a major expansion of private savings plans. Today the new private funds cover one in four Slovene workers.

- Turkey enacted a reform in 1999 that increased the retirement age, discouraged unregistered employment, and increased the ceiling on covered wages. In 2001, it authorized supplemental private pensions. Turkey is now planning further changes to strengthen governance of the public scheme, with particular regard to the collection of contributions.
- Romania debated a major privatization of its public pension scheme for several years but did not enact it. In 2000, the government enacted modifications of the public scheme that included an increase in the retirement age. It is now developing legislation that will authorize supplemental occupational pensions on a voluntary basis.

It is noteworthy that three of these countries – the Czech Republic, Romania, and Slovenia – vigorously debated the privatization of their public pension schemes along lines adopted by the first group of countries. In each case, the government's decision to forgo this option was based in part on recognition of the high transitional financing costs of moving from pay-as-you-go to advance funding of pensions. In the Czech Republic and Slovenia, the government's posture has also been influenced by strong opposition from trade unions, who perceived pension privatization as undermining the public social insurance system. In addition, as both countries had relatively low levels of external debt, they may have been less open to the influence of international financial organizations that favor privatization strategies.¹³

To sum up, virtually all the accession countries are modifying their public pension systems. Some changes (increasing the retirement age) are common to countries across the region, while others move schemes in diverse directions (revising benefit formulas to increase or decrease sharing of risk). A significant minority (five countries) is scaling down public pension systems and redirecting their contributions to new, commercially managed individual accounts. A large majority of countries is encouraging workers and their employers to save more for retirement on a voluntary basis.

II. Looking ahead

While all the accession countries have made significant changes to their pension systems, these systems continue to face genuine fiscal, economic, demographic, and administrative challenges. Finding consensus on workable measures to address these is one of the main tasks facing their governments. The sustained centrality of the controversy over public vs. private approaches has to an extent impeded progress, sidelining some important issues and distorting others.

First and foremost among the issues in need of greater attention is scheme governance, and in particular, the collection of pension contributions. As a result of the growth of self-employment and the informal economy, most accession countries suffered a loss of scheme contributors during the 1990s. In some of the former socialist countries these losses were dramatic, on the order of 25 percent or more of previous contributors.¹⁴ At the same time, underreporting of wages has become more widespread. The consequent drop in revenues is placing great pressure on national pension schemes, requiring state subsidies which are fiscally burdensome or cuts in benefits that pose hardships for the elderly.¹⁵ The main solution being pursued, as described earlier, is the unification of collection efforts within the government, often under the tax authority. This approach, which can rectify certain forms of evasion, should be complemented by new strategies that can reach firms and workers in the

informal and gray economies whose transactions are not reflected in government agency records.¹⁶ In addition, high-level action is required to enforce the contribution requirement on parastatal organizations in some countries. Since no pension scheme, whatever its design, can be successful without revenues to pay benefits, this is an issue with major importance for all.¹⁷

A second area is disability pensions. In most accession countries the problems of disability pension schemes have received less public airing than those of old age schemes, and reform legislation, where enacted, has been narrower in scope and has come about, in most cases, as an add-on to more major old age legislation. In general, the disability reforms of the 1990s aimed at sharpening eligibility standards and focusing the schemes more narrowly on their core function of replacing lost income. Our work shows that these reforms have reduced scheme expenditures and growth but have had little effect on rates of work by disabled pensioners.¹⁸ On the contrary, in most countries these rates have dropped. This situation will become more critical as populations age and larger numbers of older workers with mild or moderate health problems seek disability pensions. It is necessary to prepare now by integrating pension schemes with vocational rehabilitation and other measures that enable and encourage these workers to remain in or rejoin the labour force.¹⁹

Yet a third area is the gender dimension of pension reform. In many accession countries, the reforms of the 1990s had a skewed gender impact, in general disadvantaging women in relation to men.²⁰ Given the persistent gender wage gap, women have lost comparatively more from reforms that base benefits more closely on each worker's own wages and contributions – e.g., notional defined contribution schemes and commercially managed individual accounts. Our work points as well to a particularly damaging effect of combining (i) the elimination of redistribution in the pension benefit formula with (ii) the continuing option for earlier retirement with reduced benefits, as has occurred in Poland. This combination will reduce women's pension levels substantially in relation to men's and raise their risk of poverty throughout retirement. Ironically, given the lower retirement ages that women enjoyed in the former socialist countries, reforms to equalize the retirement age have meant greater increases for women than for men. Perhaps most importantly, our studies document that the use of separate life expectancy tables for men and women in converting individual accounts to annuities at retirement entails damaging effects for women and greater exposure to poverty in retirement.

Overlooked in most countries in the 1990s, gender analysis should be part of the consideration of every reform proposal. Such enhanced attention can cast reforms in a new light, reveal surprising consequences of particular policy choices, and empower organizations with an interest in gender equality to participate more effectively in reform deliberations.

While these issues have been overshadowed in some countries by the controversy between models, there is one area where it has distorted public understanding. This is the question of national aging. As reflected in the title of the World Bank's well-known work, *Averting the Old Age Crisis*, the scaling down of national pension schemes and reliance on individual savings were originally portrayed as a means of avoiding the financing problems that aging poses for pay-as-you-go pension systems, i.e., rising deficits resulting from a progressive fall in the ratio of

contributors to beneficiaries. Individual savings schemes, it was argued, would avoid this financial crisis by enabling each worker to save for his or her own retirement. While intuitively appealing, this argument has since been abandoned by economists and analysts of all persuasions based on a demonstration that national aging affects both pay-as-you-go and “funded” schemes. In macroeconomic terms, both types of schemes are mechanisms for dividing current GDP between workers and pensions; and whichever is adopted, the working generation must still support the retired though sharing part of the wealth it produces, either by direct contributions or through the purchase of the assets in their individual accounts. Given this reality, the shift from pay-as-you-go to advance funding does not avert the challenge of aging. This challenge must be met by other measures.

Central among the measures that must be considered in dealing with national aging are macroeconomic and labour market policies which increase the number of jobs in the economy and in this way create space for older workers. At the same time, pension reforms are needed which motivate and enable older workers to remain in the work force or to retire gradually. There is also a need to consider broader reform measures. More liberal immigration policy can raise the fraction of productive workers in each country’s population.²¹ And measures that promote national productivity can increase the size of the economic pie from which support for retired persons must come. Such measures will make it easier to support the elderly under any type of pension scheme.

It is noteworthy that these were among the key conclusions of several recent conferences focusing on aging, including the Committee on Social Security of the International Labour Conference (Geneva, June 2001); the World Summit on Aging (Madrid, April 2002); a follow-up Ministers’ Conference on Aging sponsored by the UN Economic Committee for Europe (Berlin, September 2002); the Conference on Social Dialogue and Aging in EU-Accession Countries sponsored by the ILO and the German and Japanese governments (Budapest, November 2002), and the Subregional Conference on the Restructuring of Disability Pension Schemes sponsored by the ILO and the Czech government (Prague, December 2002).

In considering these and other options, it is necessary for governments to extend their deliberative processes to their social partners, as well as all others with an interest in the future of the pension system. Only through open social dialogue can each country find the right mix of policy solutions for its own priorities, values, and resources. And only this approach can endow the reforms with the relevance, legitimacy, and public support that they require to endure and succeed.

In some countries, such efforts will need to strike a new balance between the competing goals of economic sustainability and social adequacy of benefits. As has been shown, this balance tilted far in the direction of the former in some countries in the 1990s, resulting in pension systems that leave workers at significantly greater risk of poverty in old age. This retreat from risk sharing is particularly ill suited to the new market economies of Central Europe, where workers are exposed to many new kinds of risk and thus have a greater need for collective arrangements to protect them.

Time has been lost with the controversy and its miscast solution to national aging. Still, all the above are real options for addressing the demographic challenges

of the next fifty years, challenges on which the controversy has focused a spotlight. These options will require and reward greater attention by governments and their social partners in years to come.

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² That is, it is now recognized that a shift in the method of pension financing does not change the burden of supporting the elderly, which must come from current GDP in any sort of pension system. See section 3.

³ The contributions include some imputed interest based on a wage index.

⁴ However, there is no hard empirical evidence on the effect of this incentive.

⁵ In the Slovak Republic, preferences were eliminated in 1992 (effective in 1993) but were extended annually during the 1990s in response to strike threats. In 2000, employment periods ceased to be counted for purposes of entitlement to privileges; however, the right to privileges based on earlier employment periods will continue until 2023.

⁶ For example, in Hungary the Pension Insurance Fund is charged with recording each worker's contributions in an individual account but does not have access to information on collections, which fall under the purview of the tax authority.

⁷ It has established 48 such categories. *Pensions International*, "Bulgaria: Funds show only slight growth", March 2003, p. 11.

⁸ Increased borrowing is problematic for many countries due to high existing public finance deficits. In addition, in the context of the Maastricht Treaty (protocols to Article 109), annual budget deficits (including social security) should not normally exceed three percent of GDP and accumulated debt of less than 60 percent of GDP.

⁹ Elaine Fultz, editor, *Pension Reform in Central and Eastern Europe, Volume 1, Restructuring with Privatization: Case Studies of Hungary and Poland*, Budapest: ILO CEET, 2002.

¹⁰ In Hungary, in 1998-2000, for the industry as a whole, the rate of return so computed averaged approximately -4.1 percent (7.1 percent growth against average inflation of 11.2 percent). In Poland, net-of-inflation returns for all firms across the industry ranged from a high of -3 percent to a low of -14 percent. These rates were computed for the period September 1999 to June 2001.

¹¹ Because they are financed by additional contributions, these arrangements do not involve transitional financing costs. As noted earlier, the reform adopted in Lithuania in 2002 is an exception. Here participation is voluntary but financed by revenues from the public pension system for those who join.

¹² The remaining countries -- Cyprus, Lithuania, and Malta -- do not fall neatly into either group. As previously explained, Cyprus continues to rely on its public pension scheme as the primary instrument for retirement protection; it has not adopted either the second model or private pension schemes for voluntary individual savings. Lithuania adopted a hybrid approach in which the second tier is voluntary but financed from public pension contributions for those who join. In Malta a three tier system has been proposed but met with opposition from trade unions, and no consensus has been reached.

¹³ Katharina Müller, "Between State and Market: Czech and Slovene Pension Reform in Comparison" in Elaine Fultz, editor, *Pension Reform in Central and Eastern Europe, vol. 2., Restructuring of Public Pension Schemes: Case Studies of the Czech Republic and Slovenia*, Budapest: ILO, 2002.

¹⁴ R. Palacios, M. Rutkowski, and X. Yu, *Pension Reform in Transition Economies*, World Bank, Washington, D.C., 1999.

¹⁵ The latter have been achieved largely through the failure to provide adequate inflation adjustments.

¹⁶ For example, contributions could be collected as a levy on the output or inputs of certain industries or based on an estimate of the labour necessary for certain types of activities (e.g., construction).

¹⁷ This need for greater attention to contributions was underscored at the Ljubljana pension conference (November 2002), sponsored by the ILO in cooperation with the Government of France, the Council of Europe, and the Social Cohesion Initiative of the Stability Pact for Southeastern Europe. Its conclusions emphasize improvements in scheme governance as the most pressing need in the region and provide a framework for focusing greater attention and expertise on improving collections.

¹⁸ E. Fultz and M. Ruck, editors, *Reforming Worker Protections: Disability Pensions in Transformation*, Budapest: ILO, 2002.

¹⁹ The other measures include tax policy and provision of assistive technology that enables some people with disabilities to work.

²⁰ E. Fultz, M. Ruck, and S. Steinhilber, editors, *The Gender Dimensions of Social Security Reform in Central and Eastern Europe: Case Studies of the Czech Republic, Hungary, and Poland*, in draft, ILO CEET: Budapest, 2003.

²¹ However, the aging of immigrants must be considered as well.