Pension Reforms Revisited
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All Countries in the Europe and Central Asia Region Have Undertaken Reforms

- Reforms have resulted in varied system designs
- Reforms have taken various pillar configurations

Types of PAYG systems in ECA region
- Conventional PAYG
- Point system
- Notional accounts
- None

Pillar Configuration of ECA Pension Systems
- First Pillar only
- First and Second
- Second Pillar only
First Pillar Reform Experience – Retirement Ages:

- Effective retirement ages have increased
  - for new EU member states the average retirement age in the last two decades has moved from around 56 to 60
- but ...
  - life expectancy at 56 in 1990 has been 20.8; now at 60 it is 20.3
  - women still generally allowed to retire earlier than men
  - early retirement allowed for substantial part of the population
  - disability provisions still generous in some cases
EU Pension Spending (% of GDP)

- New EU members spend less (8% versus 12%). OECD spends 7.2%.
- New EU members have fewer over 65 year olds, lower contributor base

Second Pillar Reform Experience: People Like the Individual Accounts

What is the public opinion with respect to reduction in contribution to 2nd pillar? (from Swedbank in Latvia)
Rates of Return Have Been Reasonable

Real RoR until 2007

Real RoR 2008-10

Funded Pillars Allow to Pre-pay Future Obligations of Public System

Projected Pension System Deficits

Without funded pillar
With funded pillar
Financial Crisis Has Led to Some Reform Reversals

- Financial crisis led to loss in revenues
  - Contribution revenue fell
  - Pension expenditures rose as the unemployed turned to disability and early retirement
  - Overall fiscal revenue declined making the financing of pension deficits more difficult
- Many of the added generosities in the first pillar have been removed
- Partial or complete reversal of second pillars
  - Hungary – nationalized the pension funds
  - Latvia – reduced second pillar contributions from 8% to 2%
  - Lithuania – reduced second pillar contributions from 5.5% to 2% - now proposes that if individual is willing to put in an additional 2%, the government will match that voluntary amount
  - Estonia – redirected state contributions to second pillar to first pillar in 2009 and 2010, but has now returned to 2% in 2011 and will rise to the original 4% in 2012
  - Romania – postponed planned increase in second pillar contribution in 2010, but has begun raising the contribution rate in 2011
  - Poland – proposed reducing second pillar contribution from 7.3% to 2.3%, with the possibility of an increase in the future
- Other countries are adding or considering adding second pillars
  - Czech Republic, Slovenia, Ukraine, Armenia

What Would be the Consequences of 2nd pillar Contribution Reduction? (Swedbank, Latvia)

- Destroy trust in pension system: 24%
- Consider to pay taxes elsewhere: 19%
- Reduce future pension: 18%
- Reduce motivation to pay taxes: 15%
- Consider leaving the country: 9%
- Incentive to care by myself: 6%
- Higher social security payments in the future: 2%
- Other: 7%

Source: Snapshots questionnaire August 2010
Unexpected Outcomes from Second Pillars

- Not as immune to political interference as hoped
- Limited financial literacy limits competition among funds
- Debt-financing of transition costs has led to unsustainable debt levels
- Management of pension funds costlier than expected in some countries
- Overly conservative portfolios have led to lower rates of return

What are these Reforms and Reversals Trying to Achieve?

- Objectives of pension system:
  - alleviate poverty in old age
  - provide a mechanism for individuals to partially replace their wage income
  - are there enough resources to achieve both?
- Stability of the pension policy requires that pensions are:
  - affordable in the short and long run
  - seen as adequate
  - seen as fair, both inter-generationally and intra-generationally
New Realities for Central Europe

- EU accession and increased market integration
- Tighter enforcement of the Stability and Growth Pact
- New fiscal challenges arising from slower growth following the financial crisis
- Disillusion with “miracle” cures in pension systems
- Starker demographics
  - Sharper decline in fertility
  - Prolonged emigration
  - Persistent informality

Fertility Rates Have Dropped by a Third Between 1990 and 2010

Number of Children under 5 compared to 1990

- Euro area (15 countries)
- 10 new members
Working Age Population is Shrinking Due to Emigration

Shrinking number of 30-35 year olds remaining in central Europe

Resulting Decline In Working Age Population

2010  2050
Aging of the Population

- Percentage of the population over 65

Central Europe Had Unusually High Coverage Rates Prior to Transition

Relationship between Per Capita Income and Contributor Coverage
These Factors Add up to significant Increase in Future Obligations

![Projected Pension System Deficits](image)

Before dismantling the second pillar, useful to have social dialogue on other options

- Want to avoid instability and loss of credibility in policy making
- Alternatives:
  - adjust expectations on what is adequate / fair
  - raise retirement ages further
  - lower benefits further to be supplemented with voluntary savings
  - actively seek immigration from areas with unemployed youth
  - shift some income unrelated benefits to general budget
Is Status Quo Fair / Sustainable?

End of 19th – beginning of 20th century - > Civil servants, occupational schemes
Before World War II- > Workers in industry and commerce
Since 1950s - > Farmers, domestic workers, self-employed
Since 1960s - > Increased female LF participation, higher retirement ages, baby boomers

21st century:
- Where to find new recruits? - >
- What happens if they can not be found?

Coverage & Retirement Age, Selected Countries

- Coverage is typically calculated as number of contributors over population aged 20-65
- Surest option to increase coverage statistic is to increase retirement age
Belarus: Majority of People at Current Retirement Age Are Able to Work

- 71% of early retirees continue to work (why have this scheme at all?)
- Disability and unemployment programs would provide a safety net

Lithuania: 50% of Population Continue Working after Reaching Retirement Age
**Life Expectancy at Age 65**

**EuroStat, 2007**

- Old EU members: 19; new EU members: 16. Selected FSU: 15 – **not such a big difference!** Compare with 10+ year gain in less than 40 years in OECD or 4 year gain in 20 years in new EU member states.

**Life Expectancy at Statutory Retirement Age**

**EuroStat, 2007**

- New EU member states and FSU can not afford retirement lengths of old EU members; even old EU members can not afford them and are starting to reform.
- Gender difference in old member states: **4.6**; new member states **5.4**; FSU: **7.4** years.
Raise Retirement Ages

- Need a social consensus that people cannot continue to retire young
- May need to consider modifications more applicable to an aging workforce – for example, part-time work, pay scales, etc.
- May need to include lifelong learning and retraining opportunities
- Clearly a win-win-win proposition
  - Labor force expands
  - Number of retirees are reduced
  - Pension adequacy is maintained

Raise Retirement Ages to 70 by 2047

Projected Deficits with Retirement Age Increase
OECD: Average Pension / Net Average Wage for Full Career Workers looks generous, but...

- Requires 45 year career
- Many of these OECD schemes are not sustainable and will have to be reformed

OECD Accrual Rates

- Average accrual rate of <1.5% suggests that a 45% gross benefit after 30 years of service is considered reasonable in OECD. Pensions can only be higher with substantially longer careers.
Indexation

- **Price Indexed**
  - Belgium, Canada, France, Iceland, Italy, Japan, Portugal, Spain, UK, US
- **Discretionary**
  - Austria, Greece, Luxembourg, Sweden
- **80% Price-20% Wage**
  - Finland
- **50% Price-50% Wage**
  - Switzerland
- **Wage Indexed**
  - Denmark, Germany, Netherlands, Norway
- **Price Indexed**
  - Azerbaijan, Serbia, Turkey, Uzbekistan, Latvia, Bulgaria
- **Discretionary**
  - Albania, Armenia, Georgia, Kazakhstan, Russia, Lithuania
- **Dependant on GDP growth**
  - Hungary, Estonia
- **80% price-20% wage**
  - Poland, Ukraine
- **2/3 price-1/3 wage**
  - Czech Republic
- **50% price-50% wage**
  - Croatia, Slovak Republic, Macedonia, Moldova, Montenegro
- **100% wage**
  - Belarus, Bosnia, Romania, Slovenia, Tajikistan

Changes in Pension Indexation

- Focus should be on maintaining the pensioner’s absolute consumption basket in retirement
- With declining labor force, relatively sharp increases in productivity and consequently, wages, are hoped for to help mitigate the impact of demography on the wage bill
- If these increases are directly shared with pensioners, when wages increase to alleviate the reduction in number of workers, benefits will be raised, resulting in much larger fiscal problems
- Focus of public system has to be on poverty alleviation and not on maintaining relative position of pensioner
- To be complemented with additional savings by workers if desired
Reduce Benefit Levels By Approximately 40%

Projected Deficits with Benefit Decrease

Projected Benefit Levels Relative to Average Wage

Funded Pillar

- Diversification of risk is still relevant
  - Timing of shocks to financial asset prices considerably different than timing of crisis on PAYG benefit levels

- Aging of population
  - Benefit levels will likely fall further in the future
  - To maintain adequacy of benefits, will need to save either on voluntary or mandatory basis

- But need to have adequate preparation
  - Fiscal space
  - Adequate financial markets
  - Adequate supervision and regulation
Forthcoming World Bank Report

- Looks at what actually happened in the reform countries in the last 20 years
- Aims to contribute to the dialogue on how each country can best move forward

Thank You