



New Realities of Pension Policy in Central Europe

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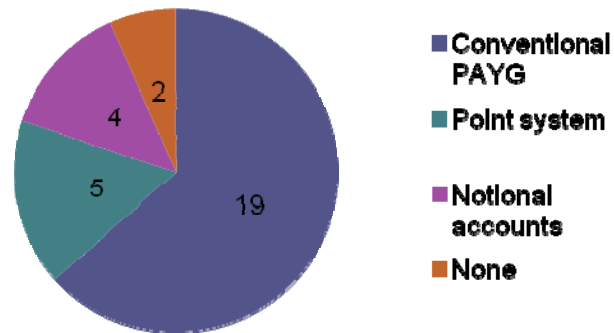
Europe and Central Asia Region

World Bank

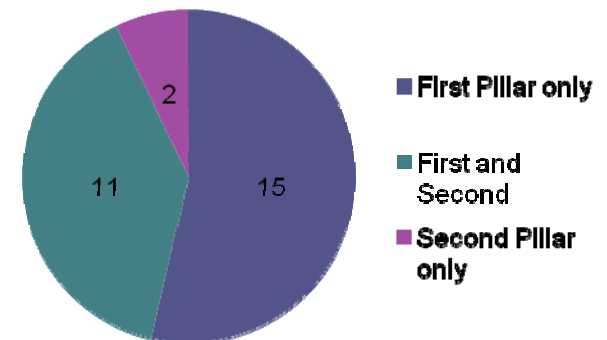
All Countries in the Europe and Central Asia Region Have Undertaken Reforms

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

Types of PAYG systems In ECA region



Pillar Configuration of ECA Pension Systems





Financial Crisis Has Led to Reform Reversals

- Financial crisis led to loss in revenues
 - Contribution revenue fell as unemployment rose and wages stagnated or 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



Pension System Objectives and How To Achieve Them

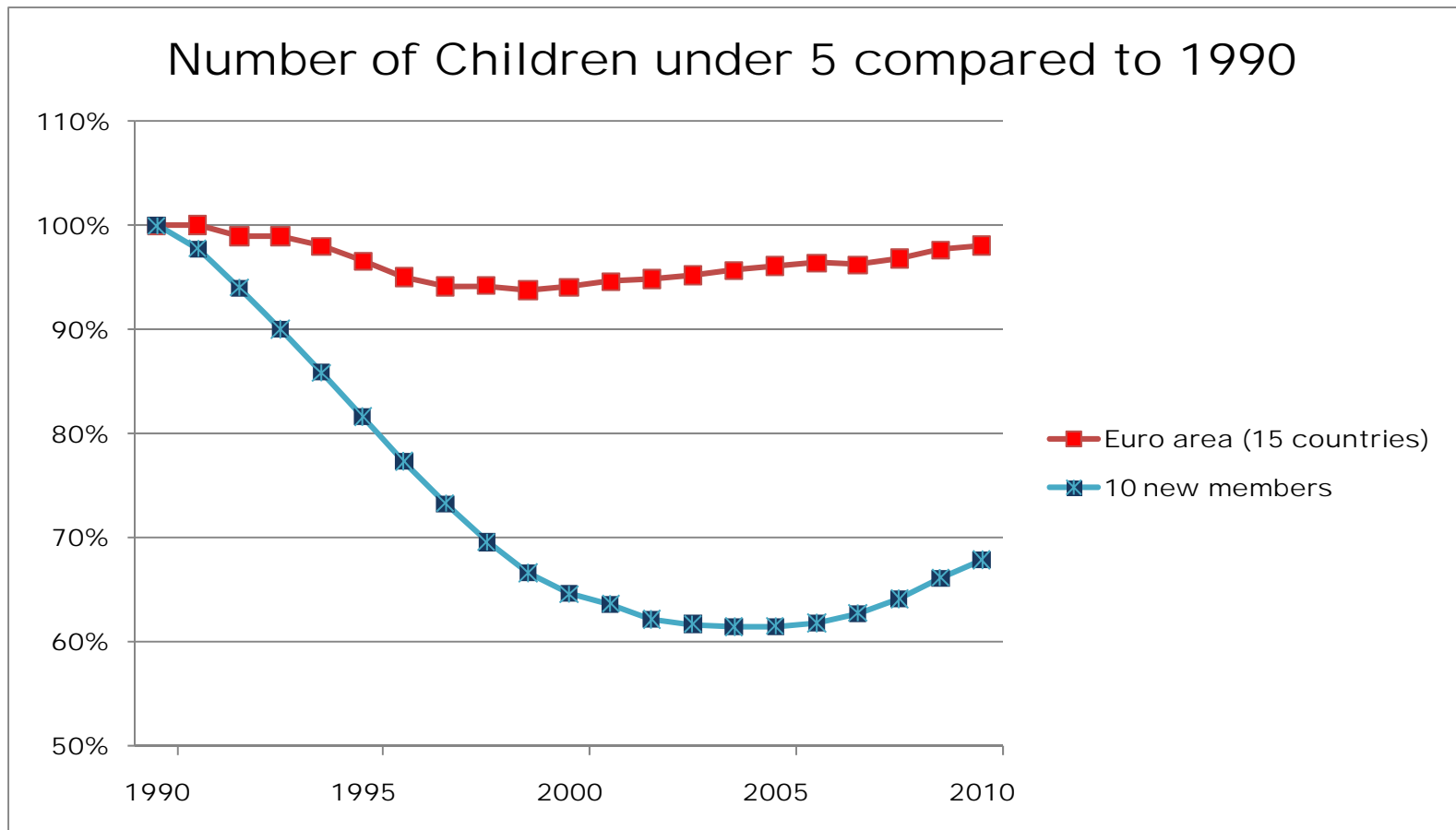
- Objectives of pension system:
 - Alleviate poverty in old age
 - Provide a mechanism for individuals to be able to replace some for working age income when they can no longer work
- To achieve these objectives, pension systems must be:
 - Fiscally affordable in the short-run
 - Sustainable in the medium and long-run
 - Provide adequate pensions
 - Perceived as fair, both intergenerationally and intragenerationally



New Realities for Central Europe

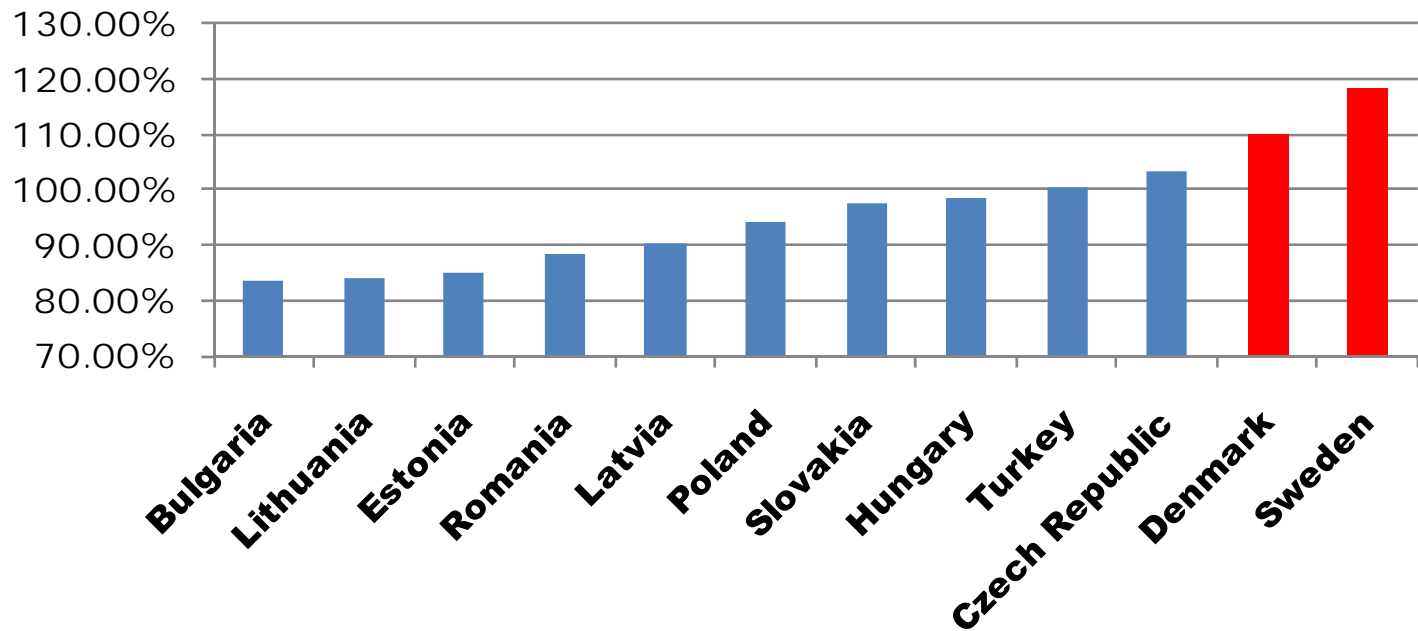
- EU accession and increased market integration
- Tighter enforcement of the Stability and Growth Pact
- New fiscal challenges arising from slower growth and lower consumption following the financial crisis
- Starker demographics
 - Sharper decline in fertility
 - Prolonged emigration
 - Persistent informality

Fertility Rates Have Dropped by a Third Between 1990 and 2010

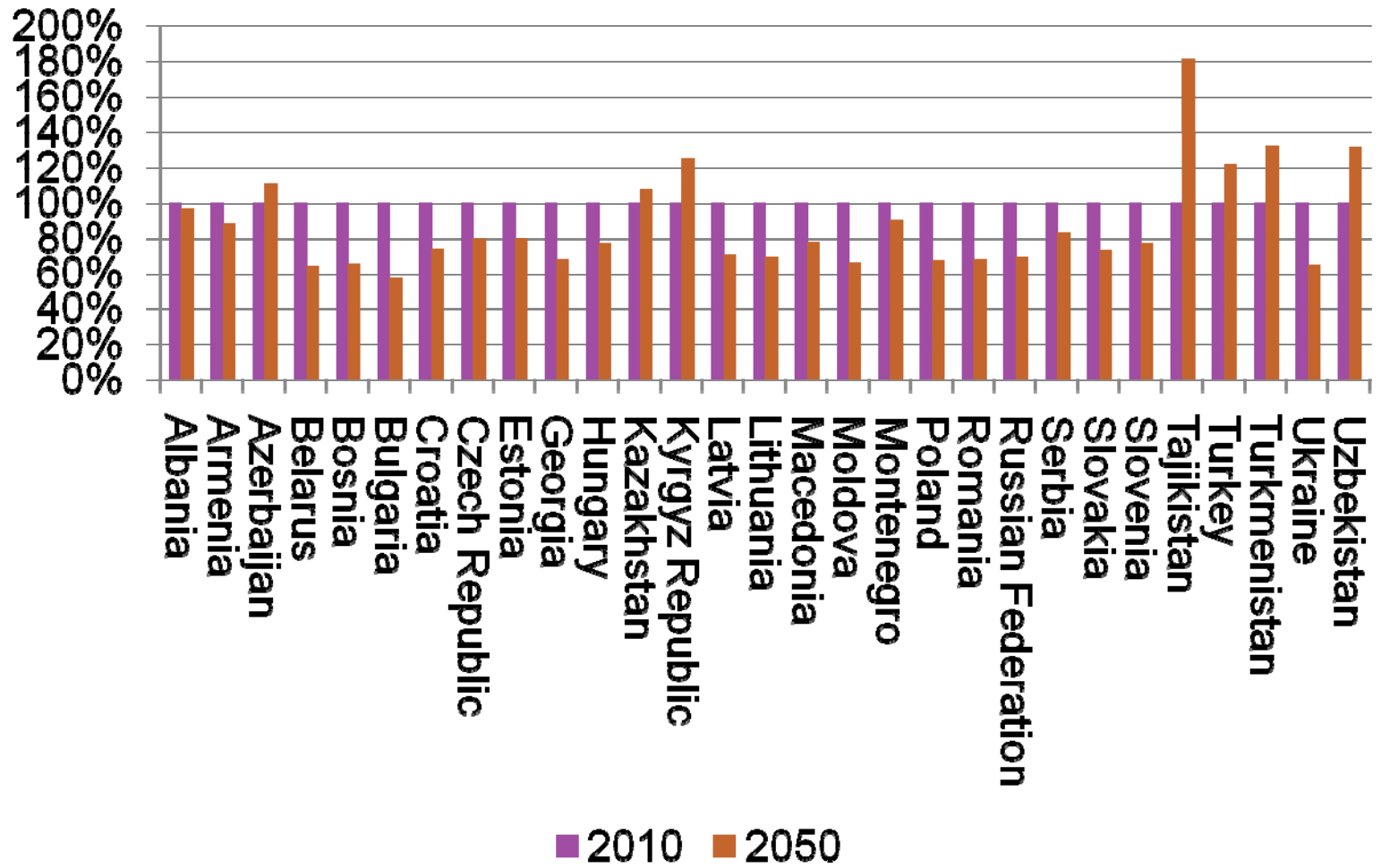


Working Age Population is Shrinking Due to Emigration

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

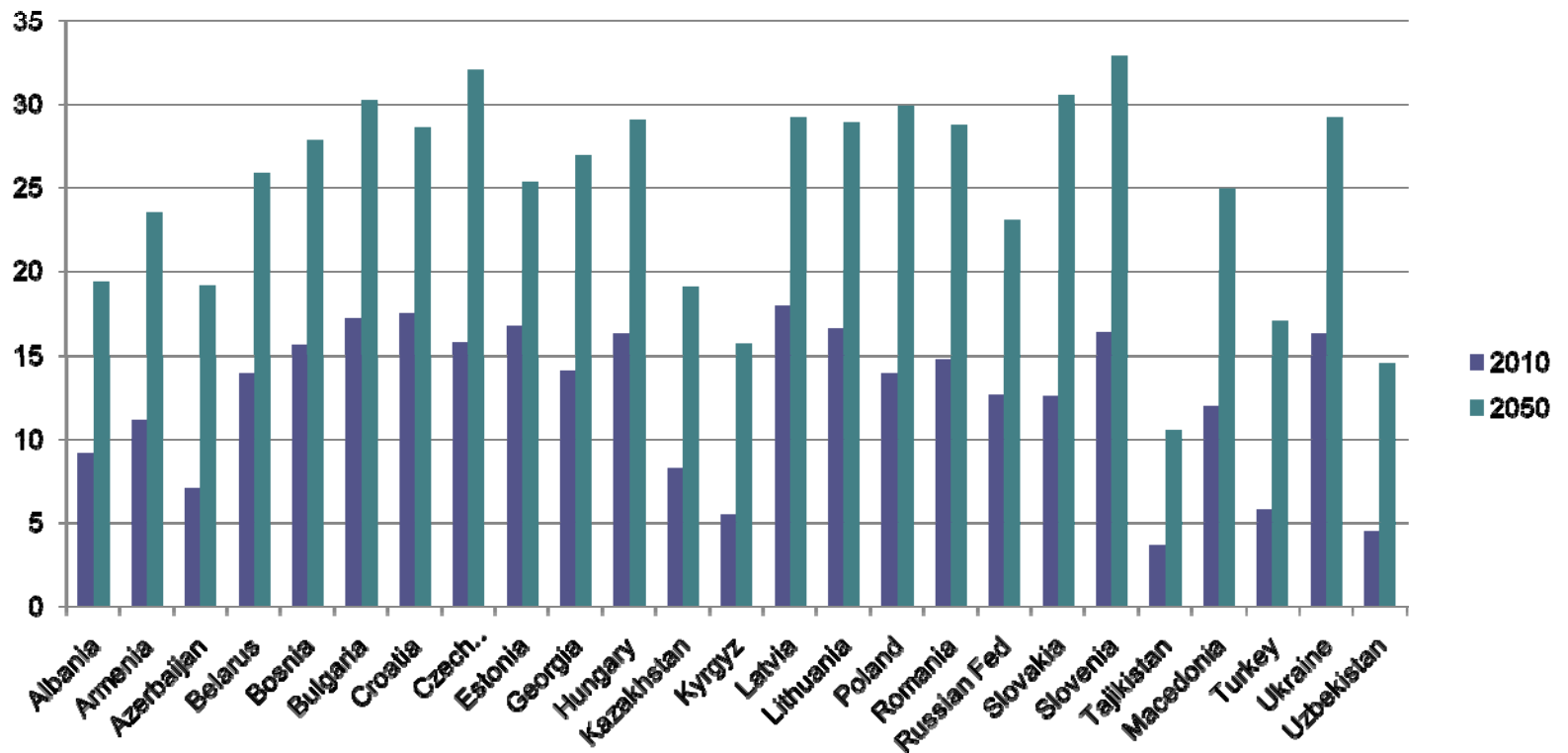


Resulting Decline In Working Age Population



Aging of the Population

- Percentage of the population over 65

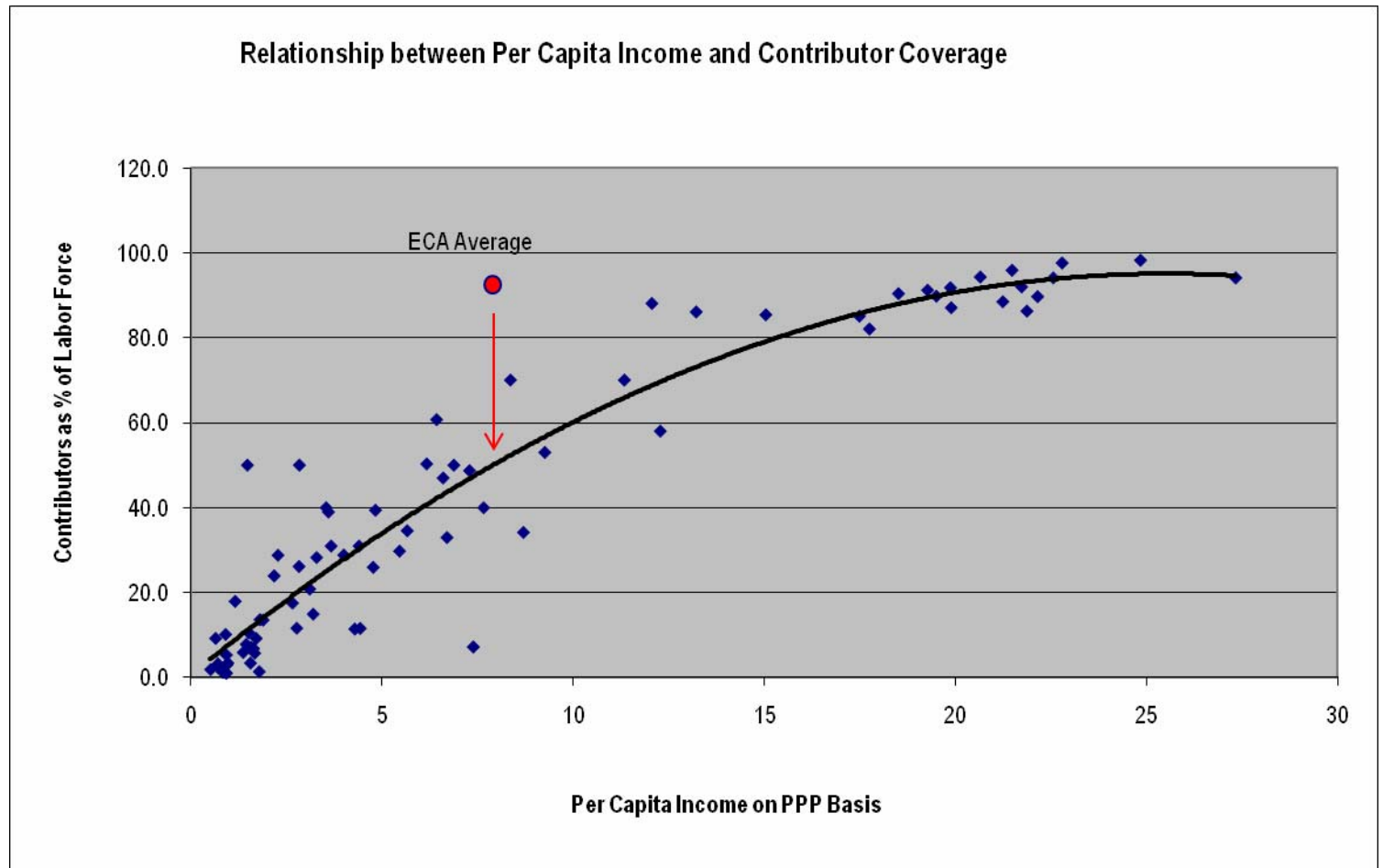




First Pillar Reform Experience

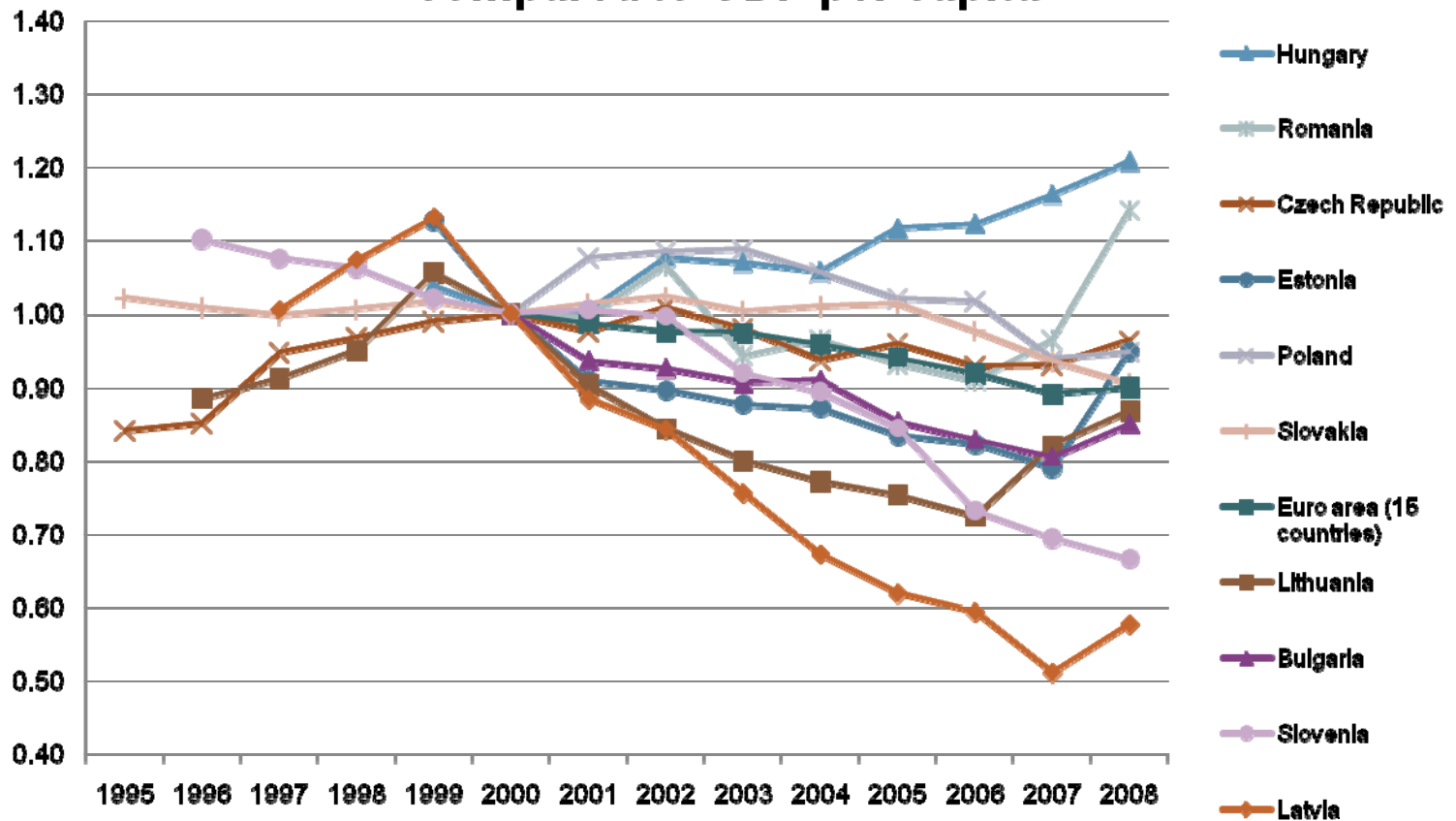
- Retirement age changes have been largely effective
 - Women still generally allowed to retire earlier than men
 - Early retirement allowed for substantial part of the population
 - Disability provisions still generous in some cases
- Persistence of informal sector
- Added generosities in boom times

Central Europe Had Unusually High Coverage Rates Prior to Transition



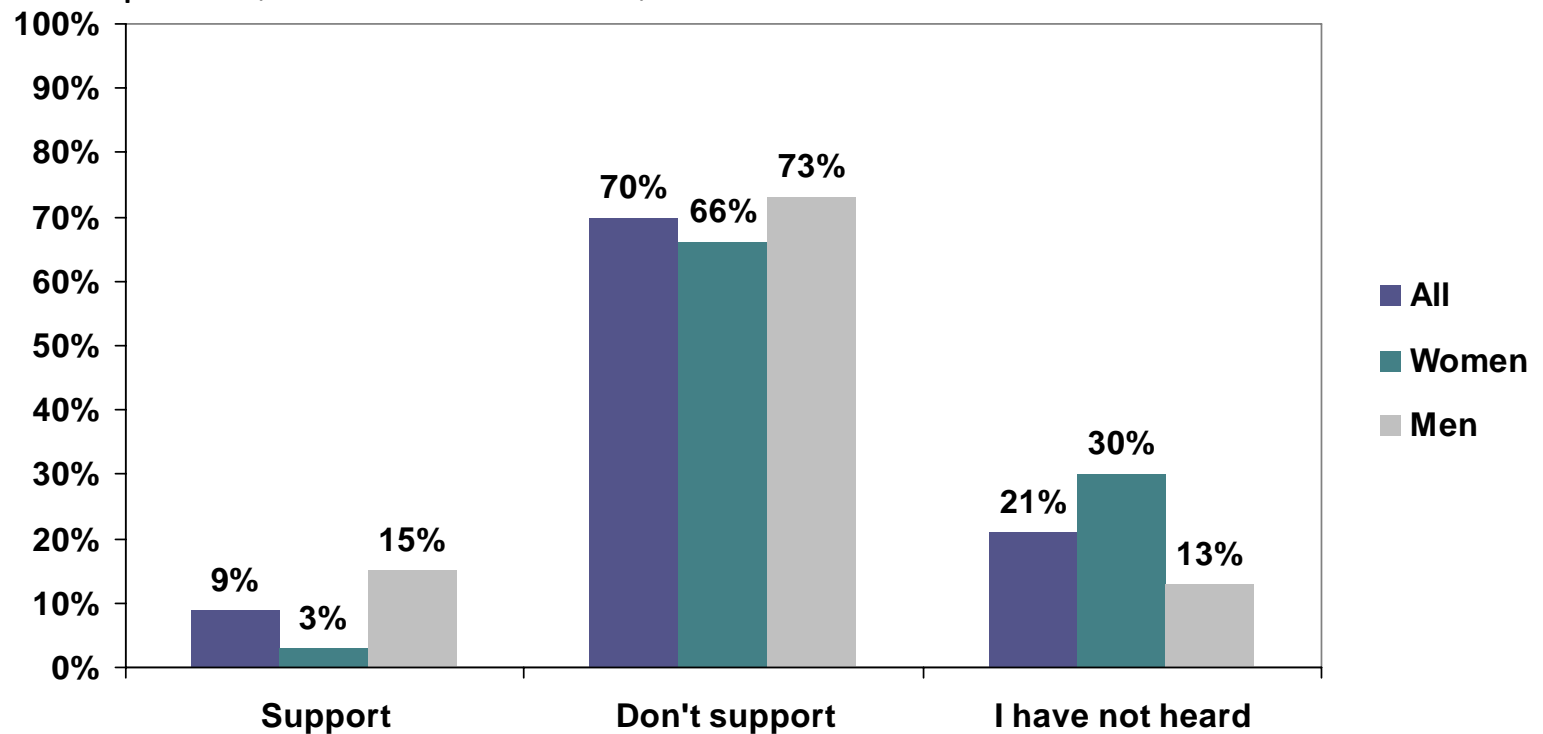
Pension Spending Increased in Some Countries Prior to the Financial Crisis

old age pension spending per 65+ population compared to GDP per capita

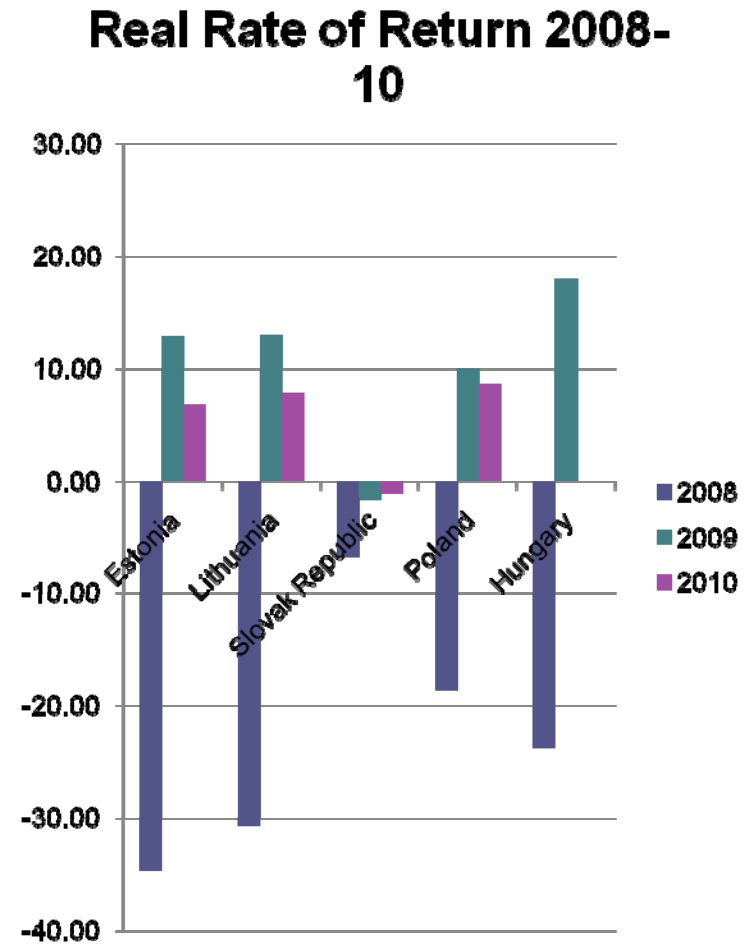
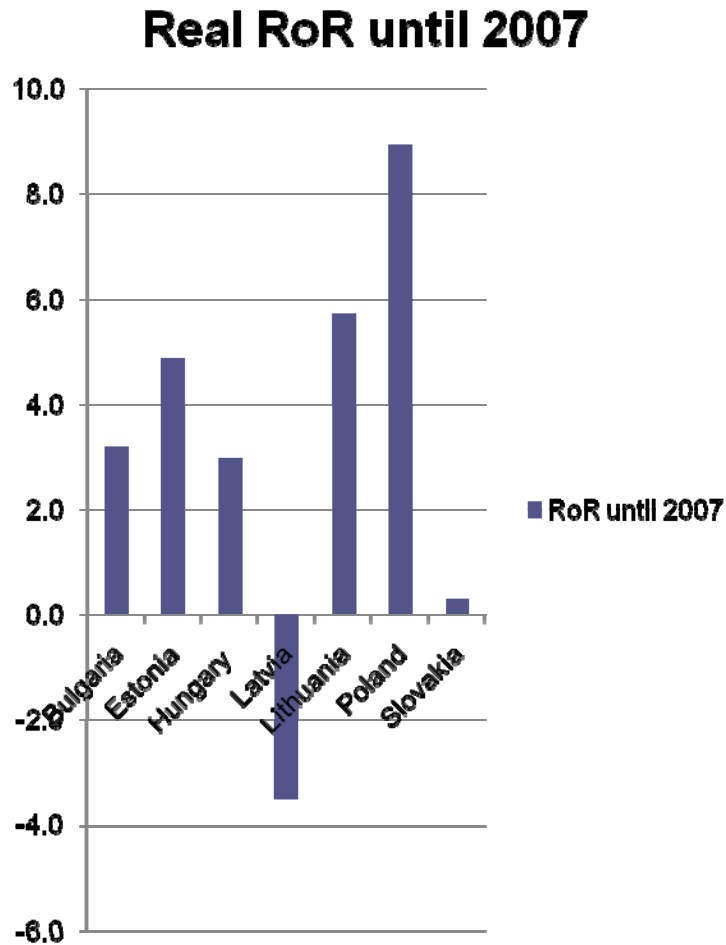


Second Pillar Reform Experience: People Like the Individual Accounts

What is the public opinion with respect to reduction in contribution to 2nd pillar? (from Swedbank in Latvia)

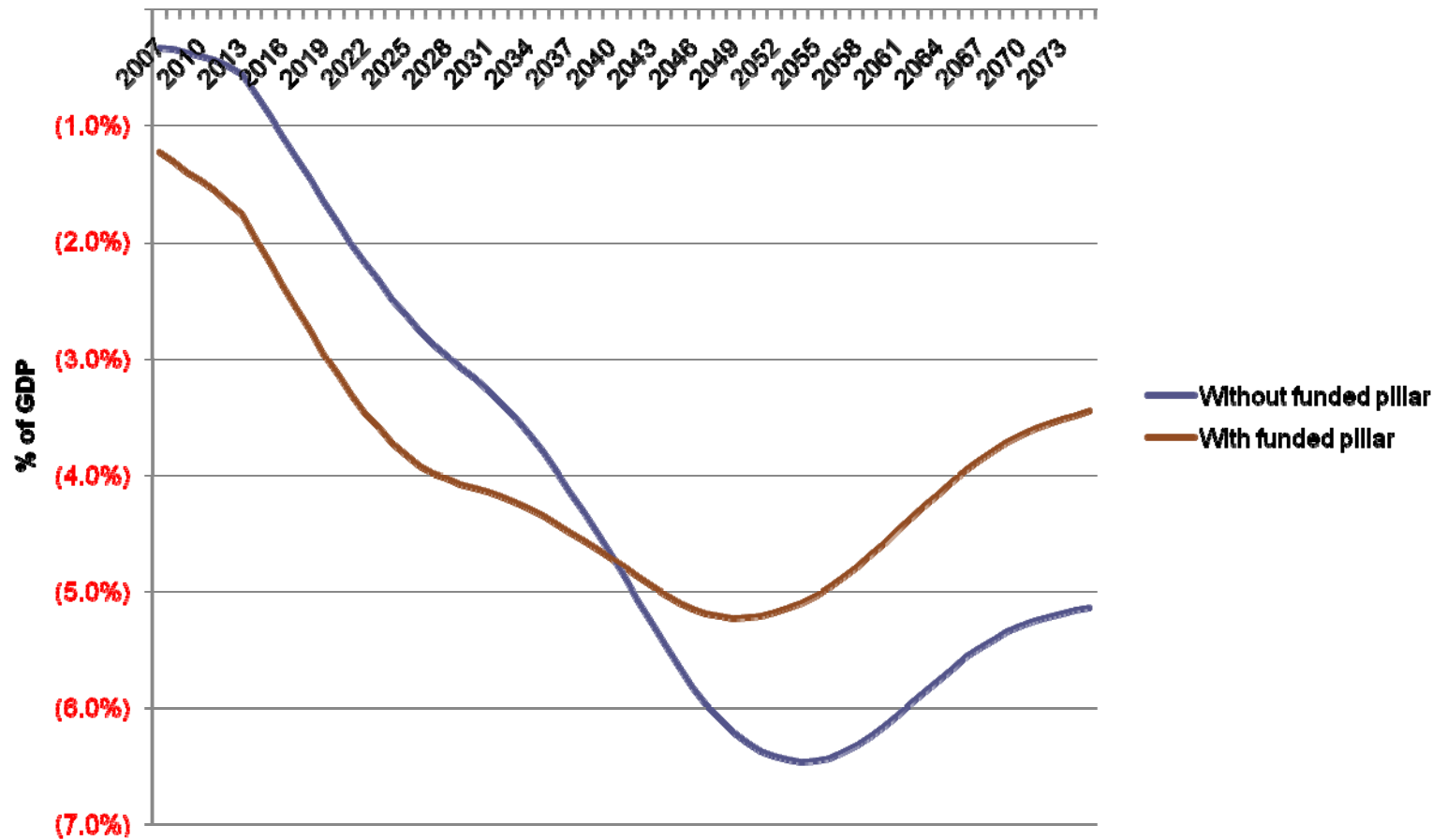


Rates of return have been generally reasonable



Projected reduction in obligations of public system

Projected Pension System Deficits

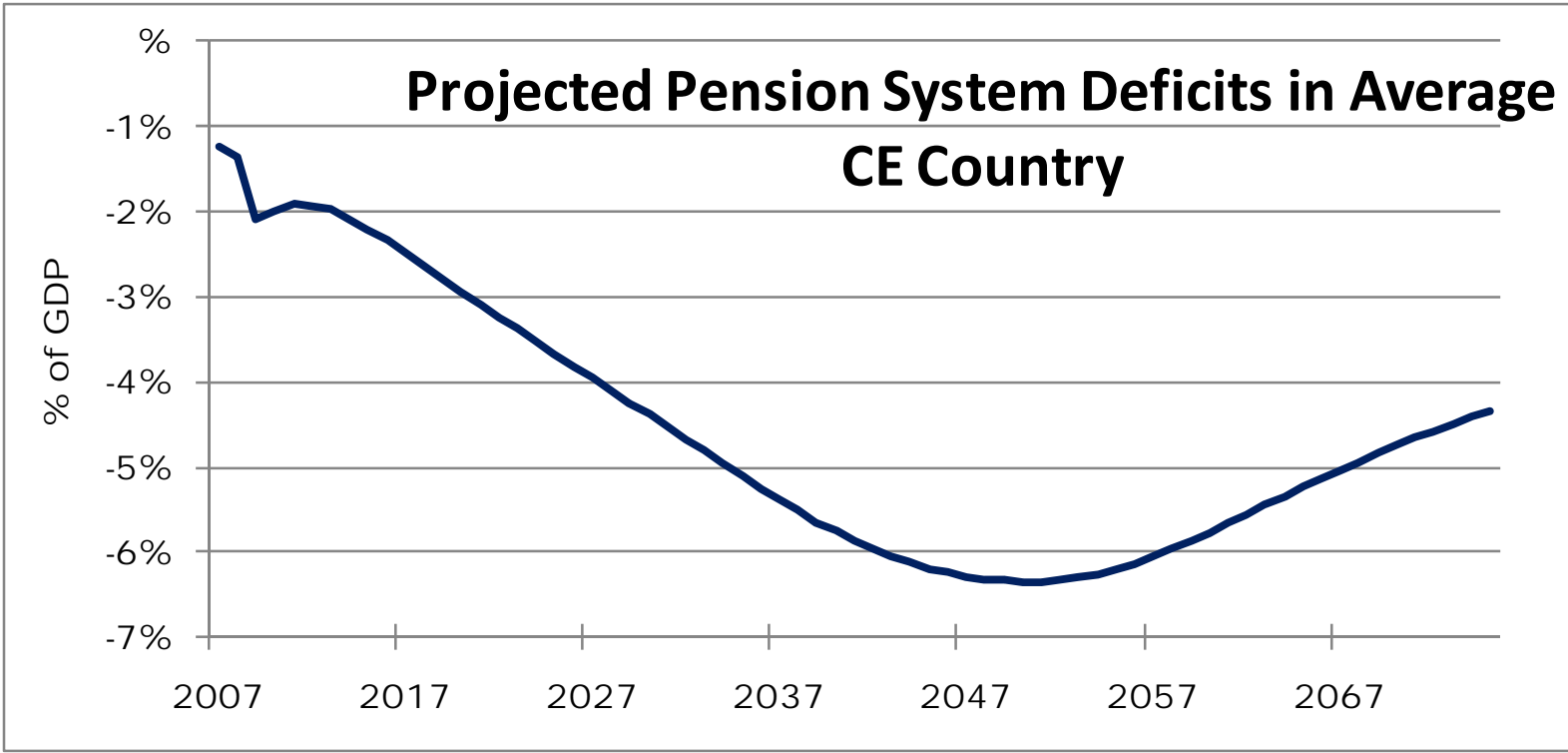




Unexpected Outcomes from Second Pillars

- 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

Impact of reversals on long-term fiscal sustainability



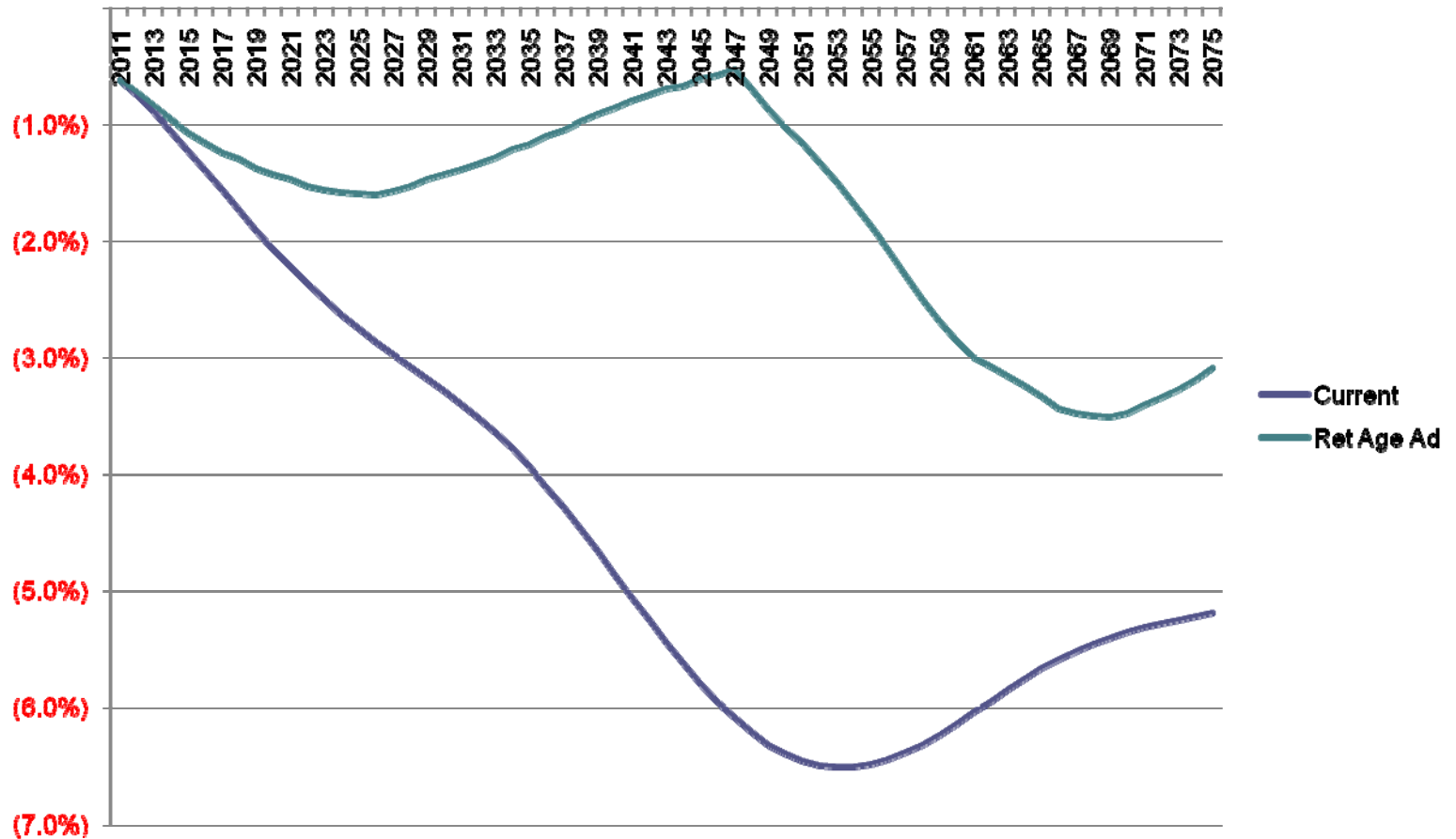


Before dismantling the second pillar, useful to have social dialogue on other options

- Second pillars are one way of dealing with the long-run demographic challenge
- Alternatives:
 - Rule out raising contribution rates
 - Raise retirement ages further
 - Lower benefits further
 - Actively seek immigration from areas with unemployed youth

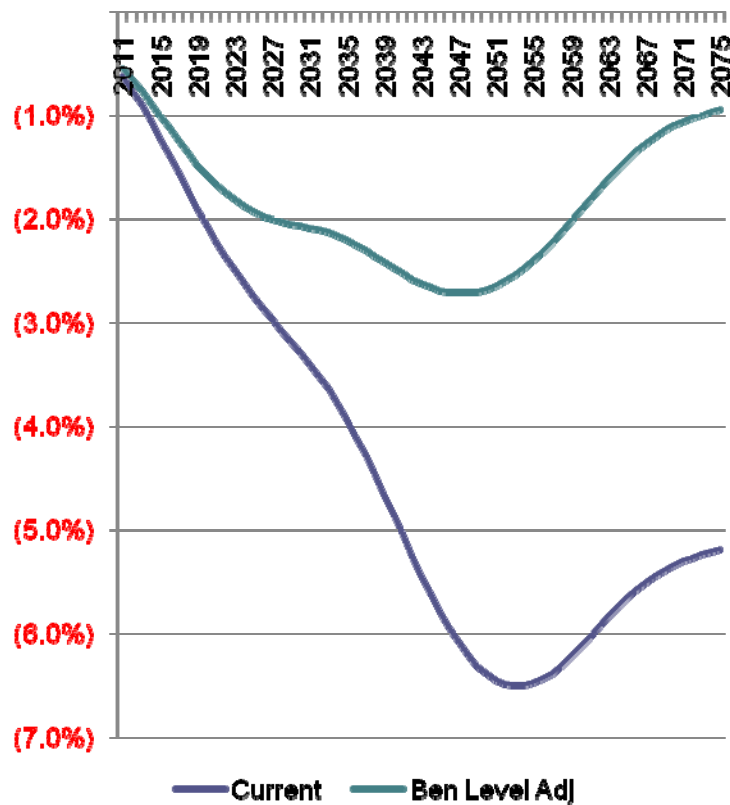
Raise Retirement Ages to 70 by 2047

Projected Deficits with Retirement Age Increase

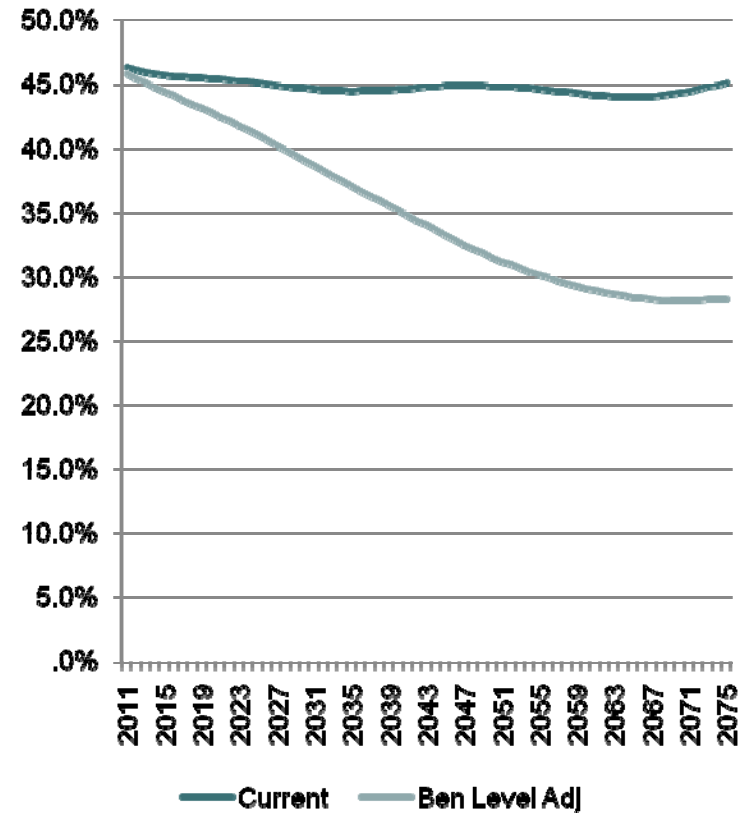


Reduce Benefit Levels By Approximately 40%

Projected Deficits with Benefit Decrease



Projected Benefit Levels Relative to Average Wage





Social Dialogue is Critically Important To Avoid Abrupt Policy Changes

- Want to avoid instability and loss of credibility in policy making
 - Do not want to turn “social security” into “social insecurity”
 - Equally applicable to countries which are considering second pillars – need to think hard about whether they meet appropriate pre-conditions
- Also has implications with respect to the credibility of overall fiscal policy
- Impacts signals to private investment community



Forthcoming World Bank Report

- Looks at what actually happened in the reform countries
- Contribute to the dialogue on how each country can best move forward