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Pension Reforms in Eastern Europe with special reference to Poland and Czech Republic

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INTRODUCTION

Over the last two centuries, Europe has developed diverse models of economic policies. In the context of the latter changes, I have here decided to analyse the evolution of pension systems which appear particularly emblematic of such a differentiation due to their social matrix. As a matter of fact, my interest in social security systems is driven by the willingness to observe how specific choices have impacted individuals' personal sphere in one of the most delicate phases of their lives.

This thesis traces the development of pension policies in Eastern Europe aiming at highlighting points of convergence and divergence with the path undergone by Western Europe throughout the same time span. For clarity purposes, Eastern Europe here refers to a core of states that were brought together by a common membership to USSR.

In order for the comparison to be effective, I have chosen to start with the analysis of the evolution of pensions in Western Europe (WE) by assessing two alternatively implemented pension systems: the Bismarckian and Beveridgean Models, whose founding principles and general conceptualisations have featured WE in the late 19th century and early 20th century.

Following their paths, the shifts occurring after the end of World War II are contextualised in these countries' dramatic and ever changing social and economic scenarios. Despite major differences, all reforms share a common expansionary matrix, aiming at integrating what were considered rudimental pre-war schemes.

To this extent, the effects of the costly 1950s-1960s expansionary policies are advanced in the section dedicated to the mid-1970s further shift, this time pointing out the widespread confidence in the early retirement option, granted to a large portion of the working population in accordance to increasingly higher unemployment rates.

Ultimately, the final massive transformation is included in the final paragraphs of the first chapter, which retrace the attempt to gradually overcome the century long implementation of publicly managed pension systems towards partial privately fully funded formulas.

Describing the path undertaken by WE countries appears functional to the thesis' central study, that is the analysis of broad waves of reform in Eastern Europe which are inevitably linked to the former thus sharing several choices and often timing as well.

In fact, Eastern European countries shared the Bismarckian tradition for different reasons: on one hand, an inevitable emulation of neighbouring countries' policies, in line with a rudimental diffusion mechanism and on the other, direct implementation of western occupied territories on which home country policies were applied.

A ground-breaking shift is registered in the aftermath of World War II: its tragically well-known comprehensive consequences were coupled with an invasive Soviet political and territorial occupation. These will be analysed in terms of modifications made to Eastern European Bismarckian-rooted pension systems, altered both in terms of scope and scale. The latter adjustments, carried out on a small though steady scale, were overall grounded in an expansionary trend thus leading to deficit-based pension systems in the 1970s.

In line with such a deficient system, the early exit retirement option was portrayed as a successful solution. The dedicated paragraph will trace the different features of the Eastern European implemented version of such an innovative option when compared to the one introduced by Western European countries.

Parallelly, ample space will be given to the turning points after the collapse of USSR and the slow overcoming of soviet centrally planned policies, involving the management of pension system as well. To this regards, the path towards implementing fully or partially privatized systems will be thoroughly discussed, especially in light of these being both diametrically opposed to the previous publicly and centrally managed and in light of the variety of driving forces and development tendencies which took part in the privatization process.

Finally, two case studies will be portrayed, Poland and Czech Republic, as they represent two different paths undertaken within Eastern Europe after the end of the soviet based centrally planned economy management, especially as far as the introduction of a privatized component within the pension system is concerned.

CHAPTER I: THE EVOLUTION OF PENSION SYSTEMS IN WESTERN EUROPE

1.1. The origins of modern public pension policy

1.1.1. The Bismarckian Model

When portraying an assessment and comparison of the European social insurance systems, a general classification may be carried out, despite the current considerable differences among Western European countries. In fact, two distinct pensionary models have been considered as fully fledged examples for most European countries: the Bismarckian Model and the Beveridgean Model. The present paragraph will start with the assessment of the Bismarckian model, chronologically antecedent when compared to the Beveridgean model.

The Bismarck system dates back to 1889, year in which German Chancellor Otto von Bismarck introduced a contributory old-age pension system for industrial and lower paid white-collar workers, making Germany the first country in the world to introduce a compulsory national old-age pension scheme.

Interestingly, one must recall that in 1844 Belgium had introduced a "compulsory sickness, invalidity, old-age, widows' and orphans' insurance scheme for seamen[1]". The main differences between Bismarck's scheme and the above-mentioned one lies in their sector specificity and in their operating as informal initiatives, through lump-sum benefits to specific high-risk working classes, rather than as institutionalised means of assistance.

On the contrary, Bismarck's old-age insurance program aimed at covering as much as half of the working population: 40% right after its implementation and reaching 54% by 1895. The novelty of this model concerned its obligatory nature: all employers had to comply with it and were to be held responsible for not doing so.

[1] Arza and Johnson, "The development of public pensions from 1889 to the 1990s.", 54.

More specifically, "it was financed by social contributions and managed by public bodies with representatives of owners and workers and provided modest earnings-related benefits for industrial workers and their surviving families"[2]. Formally, contributions were paid in 50% by employees and in 50% by employers, assisted by the central budget. The employers' contributions were then collected and transferred to an insurance institution which was obliged by law to invest them and regularly pay pensions.

In addition, according to recent studies, promoted by the Centre for Economic Studies based in Munich (CESifo), its main features have been identified as: its covering solely either employees or those under gainful employment and financing was via contributions, graduated based on income and contributions' payments are delivered based on wages or salaries[3].

Moreover, Bismarck's pension scheme was part of a broader set of social insurance reforms and initiatives promoted within a specific political and electoral gaining perspective. His main goal was that to weaken the ever-rising popularity of socialist parties thus an attempt to integrate German blue-collar workers, core of the socialists' electorate. To this regard, in 1890 the first national insurance funds were founded, followed by the 1911 compulsory pension insurance covering white collar workers as well. A few years later, the retirement age was lowered to 65. The system's implementation was put to a halt in 1933, year in which the pension expenditures were used to finance the government's rearmament programme[4].

1.1.2. The Beveridgean Model

Equal importance must be given to the Danish scheme, set up in 1891 and currently considered as the forerunner of the Beveridge Model, which gained more popularity and recognition as an alternative key model for pension policymaking. Regardless of this, Denmark established a specific benefit for the elderly in need, dispensed by the central government and financed by tax revenues. The Bismarckian and

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[2] Kohli and Arza, "The political economy of Pension Reform in Europe", 252.
[3] CESifo Report, 70.
[4] Poteraj, *Pension systems in 27 EU countries*, 51-52.

Danish model soon became two valid and institutionalised models of old-age income protection, emulated by other countries.

Despite following different criteria and different regime types, what both have in common is their providing low benefits at high retirement ages. Given the low life expectancy featuring those years, this meant that few elders were receiving benefits and only for a short period of time. Due to this combination of factors, government pension expenditures were extremely modest: let us consider that in 1930, average European social expenditures mounted to 5% of GDP[5].

As previously mentioned, the Beveridge model is considered as the alternative preeminent model to the Bismarckian one. It is named after William Henry Beveridge, who in 1940 was asked to provide an unbiased assessment of the then existing British social insurance system along with submitting proposals as to modify it. Beveridge presented a detailed report to the British Parliament: it "contained concrete proposals for the creation of a comprehensive social insurance system which included the integration of social insurance forms, the creation of a general health service including workplace accident insurance, the introduction of family assistance, the maintenance of a high and stable employment rate as well as protection against mass unemployment"[6].

As far as pensions were concerned, Beveridge proposed charging each working person a fixed weekly contribution for pensions to be paid on a weekly basis, granted to whoever reached the age required by law. Beveridge's proposals lied the foundation of Britain's post-war social insurance system, envisioning benefits for the entire population, financed by the state's budget and calling for uniform lumpsum contributions[7]. The 1942 proposals were enforced in the aftermath of World War II, between 1945 and 1948, gradually enlarging the pool of people who were granted these benefits.

Having outlined the main features of the two most influential old-insurance models aids the explanation of most European countries' choices to implement different versions of these two models and whose final outcomes have led to the clustering of the latter in two families, labelled as the Beveridgean family and the Bismarckian family. On

[5] Ibid.
[6] v.3
[7] CESifo Report, 71.

one hand, Anglo-Saxon and Scandinavian countries implemented basic pensions which gradually became universal and have been labelled as the Beveridgean family.

On the other hand, Western and Southern European countries (Austria, Italy, France, Belgium) followed the German model, introducing earnings-related pension systems and have been consequently labelled as Bismarckian family.

1.1.3. Causes of public pensions' growth

The debate on the reasons underlying the establishment and growth of public pension expenditures has flourished and has been constantly enriched of many different perspectives. As stated above, a gradual though steady development of public pension schemes occurred starting from the late 19th century, given the conceptual shift concerning the nature of pensions, which were no longer associated with existing disabilities, rather with the government's duty to provide basic benefits for the elderly.

Social and electorally driven issues are considered to have exerted great pressure on the decision to costly intervene on European societies. Old-age security incomes were introduced following the need to politicise the welfare of the elderly, which was becoming the focus of newly founded though already popular socialist parties. The latter were taking over many interests concerning the weakest sectors of the population, such as workers and elderly, aiming at undermining the central government.

Having said that, one may grasp the reasons for which Bismarck's pension scheme had been envisioned as part of comprehensive social insurance measures, designed to undermine the growing popularity experienced by socialist parties. An electoral weakening was thought to be achieved by "ameliorating the social conditions of industrial workers, and by directly linking their welfare to the security and economic strength of the central state; it was introduced with little initial enthusiasm from organized labor"[8].

Consequently, the process for which pensions became politicised, though varying based on single national contexts, has been identified as sharing a common feature: the

[8] Arza and Johnson, "The development of public pensions", 56.

gradual institutionalisation of the industrial and political power of organised labor in leftist parties led central governments to the implementation of measures which would incorporate that same organised labor in the traditional electorate, expressed in the governing central parties.

1.2. Adjustments in the aftermath of World War II

1.2.1. Expansionary policies

The big expansion of pension systems came after World War II, definitely overcoming the previous asset of modest coverage and limited extensiveness of benefits. From a social standpoint, one must stress the cornerstone achievement of considering retirement as an institutionalised and decorous life stage. The elderly, in the aftermath of World War II, started being recognised as individuals worthy of assistance and of protection.

Public pension schemes gradually became central to European social policy agenda, in terms of expansion and establishment. Several European countries, that had been granting benefits to specific occupational sectors, extended their coverage to the entire working population.

At the same time, "countries with only basic income protection (flat-rate or means-tested benefits) also expanded coverage, sometimes eliminating the means-testing, sometimes including new earnings-related layers in the public scheme, or mandating occupational schemes"[9]. The welfare state underwent what is commonly considered its "golden age"[10], boosted by an unprecedented economic growth and a highly efficient labor force organised in trade unions. Consequently, the latter became main actors, requiring increasingly important social insurance reforms and benefits.

Within such an everchanging and prosperous context, pensions schemes started covering broader sectors of welfare and main social risks, including unemployment

[9] Kohli and Arza, "The political economy…", 2.
[10] Wincott, "The Golden Age of the Welfare State…", 2.

benefits, work injuries and sickness. Eligibility for such coverage became more generous, reaching out to all workers and their families, retirement age was lowered and early-retirement options were introduced. Predictably, as insurance policies broadened, the administration of the latter also became a key sector affecting the management of labor, unemployment and industrial restructuring[11]. The extension of coverage to previously uninsured workers determined a massive increase in the pension expenditure, whose financial impact would have had effects in the long run, rather than in the short run.

1.2.2. Social Insurance and Multipillar pension systems

The late 1940s and early 1950s registered a shift away from the modest and rudimentary pre-war pension schemes, giving the opportunity to Western European countries to provide their resident populations with a good pension coverage.

The paths chosen by countries were destined to differ right from the beginning. Following the distinction portrayed earlier among Bismarckian countries and Beveridgean ones, here another useful terminology will be used, directly linked to the former. In fact, one may identify two post-war comprehensive pension systems: social insurance and multipillar systems. The main differences concern how benefits distribution benefits' and financing mechanisms.

Predictably, social insurance systems are of Bismarckian inspiration, granting earnings related benefits to former workers on a contributory basis[12], meaning that benefits depend on the contributions made while working. This system is financed on a pay-as-you-go basis (PAYG): current pensions are financed by current contributions.

In addition, social insurance systems generally envision a means-tested minimum pension, for those who either reach the age of contribution without having paid a sufficient amount of contributions or with a record comprising of an excessively low contribution able to grant them a minimum pension.

[11] Kohli and Arza, "The political economy…", 3.
[12] Bonoli, "Two Worlds of Pension Reform in Europe", 400.

Conversely, multipillar pension systems provide a flat-rate minimum benefit on the state's part, considered as sufficient to cover basic needs. If compared to the social insurance system, which aims at supporting the maintenance of the person's income more or less equal to the one earned while working, a multipillar system's goal is to prevent widespread poverty among the elderly.

Within such context, the role of the central state is extremely limited, leaving plenty of space to the private sector which was gradually embedded in the pension system, either in a compulsory or quasi compulsory form. On the contrary, in the former system, the state is extremely central in providing its population with a generous pension therefore significantly preventing the development of private pension provision.

Multipillar systems usually may be funded combining two different ways: the publicly provided one through a PAYG basis, same as the social insurance type, whereas their private component is generally fully funded, that is current contributions are used to finance future benefits.

Based on a country's implementation of one of the two, the portion of GDP devoted to pension expenditures significantly varies. In social insurance countries, the amount of GDP spent on pensions is extremely higher when compared to multipillar countries. The former have the entire social insurance burden on their budget, whereas the latter, given the larger role played by private pension, spend a lower portion of their national income on public pensions.

Overall, regardless of the model chosen, during the mid-1970s, Western European pension systems were all able to grant generous pensions to their populations, thanks to the low demographic pressures. In addition, they were also able to limit widespread poverty among the elderly, given the smaller proportion of older people with regard to the working population.

The implementation of either one among the above described policies had impactful consequences on many matters, as the demographic transition and consequent population aging, which revealed the sustainability degree of such implementations. According to research carried out by Bonoli, even though social insurance countries are considered to greatly suffer the population aging (conversely to the multipillar scheme), the sphere in which the two systems certainly differ is in “how population aging translates into political pressures”[13] rather than the mere aging pattern itself.

In fact, “in social insurance countries population aging is expected to result in a substantial increase in public pension expenditure and, all other things being equal, will require contribution and/or tax increase”[14]. In response to this context, governments have to either increase taxes on current contributors or cut pension benefits. Both paths are politically difficult and undeniably lead to an electorally negative impact. On the contributors’ part, having their income significantly reduced would dramatically affect households’ availabilities along with lack of certainty in terms of whether those sacrifices would then lead to benefits for their own pensions. At the same time, on the part of the pensioners’ whose benefits would be reduced, such drastic measures are politically difficult to be introduced.

When looking at a multipillar system, given the state’s limited involvement, as most of the responsibility is given to private arrangements, the political cost of required measures following an ageing population is extremely lower. The increase in contributions, required to maintain the same level of benefit, does not directly involve the government, rather increases may be the result of decisions carried out by private institutions such as pension funds, pension trusts and social partners. At the same time, if the requirement were to be truly an increase in the contributions devoted to a fully funded pension, such increase would be perceived as less damaging compared to an increase in taxes.

Finally, one must stress the underlying feature characterising both systems: their being designed to serve for that period and for male career profiles. Both offer a kind of coverage which perfectly suits a full-time working pattern, no significant interruptions and starting coverage from an early age. Predictably, such requirements could be fulfilled exclusively by males who, unlike women, are not subject to childcare and relatively long career interruptions[15]. Even though current labor markets do envision a wider spectrum of career profiles, the gradual though massive entry of women in the labor market has

[13] Ivi, 402.
[14] Ibid.
[15] Ivi, 404-407.

occurred starting from the 1960s. Therefore, the post-war pension schemes here assessed lack whichever reference and consideration towards women's profiles.

1.3. The mid-1970s shift towards pension reform

1.3.1. International macroeconomic pressures

The late 1940s shift towards overall expansionary policies lasted throughout the 1950s, 1960s and early 1970s. Governments allocated high budgetary expenditures to pensions, as these were decades of prosperous economic growth in Western European countries. Societies were that of a young and growing population with an extremely low number of elderly. As a result, pension expenditures in these three decades were rather low: for example, in 1960 the former made up 3.3% of GDP in Italy, 2.6% in France, 5.9% in the Federal Republic of Germany and 1.2% in Spain[16].

However, over the years, things started changing due to the fall of economic growth rates, demographic transition towards major ageing within the population and an overall shift away from Keynesianism towards new policies which highlighted international competitiveness, productivity and stringent public finances.

Predictably, the then existing public pension schemes which required high wage contributions in order to grant benefits to an increasing number of elderly, especially in PAYG system, did not fit in this new idea of economic asset a country should possess.

Therefore, the rhetoric of reform started to gain widespread success, aiming at rendering the public pension system financially sustainable, given the new challenges, as low fertility and increasing life expectancy. To this regard, one may point out how by 1980 pension expenditures had more than doubled in all major Western European countries: 6.9% of GDP in Italy, 7.6% in France, 9.6% in the Federal Republic of Germany and 5.7% in Spain[17].

[16] Kohli and Arza, "The political economy …", 3.
[17] Ibid.

The pressures which hit the pensionary systems were not solely impactful on the old-age insurance system. Structural constraints as demographic challenges and slow economic growth impacted the overall performance of Western European countries, altering the three-decade long deployment of financial resources used for pensions. However, epochal social transformations as the emergence of the post-industrial labor market and its consequent new demands along with an ever-changing family structure, inevitably led to new social needs, which promptly changed governments' agendas in the mid-1970s and early 1980s[18].

In fact, three important changes struck Western European fairly stable economies: first, the aftermath of the first oil price shock of 1973 led to the rise of stagflation which consequently affected European economies; second, an emerging restrictive international context boosted rises in interest rates and unemployment levels, which had a profoundly negative impact especially when in the wake of the 1979 second oil crisis. On top of that, the gradual deterioration of the Bretton Woods system throughout the decade up until its final collapse in 1976 furtherly destabilised the international spectrum.

Therefore, low levels of growth, rise in unemployment and demographically caused rises in social expenditures gave a lethal shock to quasi mature social insurance systems the countries in question were. Thirdly, since the early 1980s, a gradual though steady liberalisation and deregulation of capital markets (notably, the Single European Market) led to even greater constraints exerted on national markets and existing domestic policies[19].

Soon after, in the midst of times in which unemployment rates, inflation and budget deficits were higher than they had been in the early 1970s, Western European countries were challenged with the unbearable consequences of a second oil shock crisis. Moreover, in the late 1980s, when the international macroeconomic environment seemed to have embraced a new phase of fair stability, capital exchange controls were abolished, ending the protection which the latter granted to domestic financial markets. The complexity of the phenomena which occurred in barely two decades profoundly changed

[18] Haeusermann, "The changing conflict structure in pension reforms. Dynamics of coalition-formation in Germany, France and Switzerland", 2.
[19] Ivi, 126.

the post-war secure welfare state. Western European welfare states had reached their maturity at times in which nation states had control and decisional power over their own borders.

Finally, the changing international environment of the 1970s coupled with welfare states' levels of financing and spending along with rising levels of unemployment caused the latter to become influencing factors in the success or failure of single national performances within the increasingly constraining international spectrum.

1.3.2. Early Retirement Policy

The above-mentioned analysis of the mid 1970s economic asset may be summarised in having created mass unemployment, condition which inevitably affected the choices made by leading governments in Western Europe in terms of welfare reforms.

The most widespread social practice, promoted and implemented by strong welfare states (Germany, France and Italy) sharing a Bismarckian-social insurance tradition, was the massive use of early retirement provisions and schemes starting since the 1970s. The combination of internationally economic difficult scenarios, portrayed in the previous paragraph, led to mass unemployment within all Continental Europe.

Consequently, governments supported, starting from the 1970s, the withdrawal of older employees from employment long before the statutory retirement age. Schemes envisioning early exit from work aimed at reducing the then existing job supply of labor thus lowering unemployment, specifically youth one. This path was included in the broader endorsement on governments' part of passive labor market policies.

Unfortunately, subsequent data pointed out that the countries which made the most extensive use of early retirements scheme suffered the highest level of unemployment along with having contributed to the worsening of the already sufficiently costly welfare states these countries had established in the three decades following the end of World War II[20].

Firstly, early retirement may refer to both a "withdrawal from employment prior to age 65 (early exit from work) and the drawing of preretirement benefits until a statutory pension becomes available"[21]. As such, it is considered as social practice with massive financial consequences on the portion of GDP dedicated to social insurance/pension expenditures, leading to an overall increase in social expenditure.

In addition, early retirement impacts income and payroll tax receipts due to the consequent reduction in employment while also contributing to a premature loss of human resources. The latter, formally believed to be substituted with younger workers in the place of older ones, was only partially achieved[22]. That is why, reversing this policy became one of the central issues on the governments' agendas in many Western European countries.

Secondly, the two main reasons for which early exit from work emerged as a decisive policy were "as an unintended consequence of the expansion of social rights and as a deliberate policy to facilitate economic restructuring and reduce unemployment"[23]. As stated by Ebbinghaus, this was a reaction to both pressing social and economic demands: instead of perceiving it as a policy against the market, it was thought as a suitable instrument to promote the market itself, manoeuvring its restructure along with the rearrangement of production systems as well. On the workers' part, it offered the opportunity for them to exit the labor market in order to give younger unemployed or job seeking workers to enter the labor market earlier; on the employers' part, it provided them with the chance to restructure their workforce avoiding industrial conflicts with trade unions or other associations protecting employees.

Furthermore, when looking in depth at the development of early retirement schemes and the underlying reasons behind firms' strategies of shedding older workers, one must stress two different parallel components: the production-relate push factors and

[20] Ebbinghaus, "Exit from Early Retirement: Paradigm Shifts, Policy reversals, and Reform Obstacles." 203-204.
[21] Ebbinghaus, "Introduction", 6.
[22] Ivi, 9.
[23] Ivi, 3-4.

the protection related pull factors. Along with the institutionalised reaction promoted by single governments, there were also economic reasons boosting firms' favourable position in supporting the early exit of older workers.

Given that labor shedding or retaining of workers usually depends on the single firm's hiring-firing-training policy which in turn influences the overall management of human resources, it appears extremely useful to stress the increasingly cumbersome pressured under which firms had undergone since the 1970s.

In fact, the latter had been forced to deal with an "increased pressure to downsize or restructure due to advancing deindustrialization, new production methods, pervasive shareholder demands, and intensified international competition"[24]. On top of that, managing older workers' related statutory protection constituted an additional constraining pressure for the legal apparatuses of firms. Therefore, early retirement was considered, on the firms' part as well as on the governments' part, as the ideal solution to these numerous pressures and constraints.

However, according to Ebbinghaus neither the production-related nor the protection-driven motives are sufficiently strong and plausible when attempting to understand the success experienced by the early retirement scheme policies. To this extent, social partners are considered to have influenced and social policymaking and to have facilitated the implementation of the early retirement schemes through their political channels and intrinsic involvement in occupational welfare programs.

In light of the excessive financial cost of such policy, Western European countries experienced significant financial pressures due to this early retirement scheme or other preretirement pathways. For this reason, starting from the early 1980s most of them opted for a gradual paradigm shift away from passive labor market policies by reversing the previously implement early retirement scheme. The multiple waves of reform are the argument of the following paragraph: what can be traced here in general terms is that such abandonment was pursued in many different ways: by raising the retirement age,

[24] Ivi, 13-15.

reforming disability insurance, closing special early retirement programs, activating older workers and fostering gradual transitions towards retirement[25].

1.4. Patterns of reform in the transition to a multi-pillar system

1.4.1. Bismarckian Pension Systems' Challenges

The emergence of pension reform in the agendas of Western European states became a central element in the attempt to mitigate the effects of an everchanging both international and domestic macroeconomic asset. After having outlined the main driving factors of the Bismarckian based pension systems' deterioration along with the initial choice on the governments' part to opt for early retirement schemes, this paper continues its temporally motivated analysis of pension reform with the 1980s and early 1990s common trends in pension reform within Bismarckian-pension regimes.

The focus of policymakers, once the 1970s path had clearly failed, was towards cost containment and retrenchment of benefits: since the 1980s, all Western European countries linked to a the Bismarckian pension regime had started shifting towards a cluster of reforms, gradually implemented, which was believed to lead to a dampening of pension expenditures. As far as countries following the Bismarckian pension system are concerned numerous issues made the reforming process more difficult than in other countries lacking the Bismarckian system.

First of all, their mode of financing represented the first obstacle, as these pension systems were extremely generous in terms of their earnings-related benefits, financed out of social contributions, Consequently, pension contributions appeared as extremely high compared to the then-existing international standards.

[25] v. 22

Secondly, as these were of the defined-benefit type, they tended to distort the labor supply and "to impose a quasi-contractual obligation for policymakers to increase contribution rates, whenever pension outlays exceed revenues"[26].

Thirdly, as based on a PAYG system, current working people are those responsible for the benefits granted to current pensioners. Consequently, PAYG-financed systems are highly vulnerable to demographic ageing: as soon as the number of beneficiaries exceeds that of contributors, such system inevitably comes under fiscal strain.

Fourthly, as benefit entitlements typically derive from employment relationships as soon as there is a rise in the labor force participation there is a consequent rise in pension expenditures as well.

Finally, given that Bismarckian-pension regimes are usually categorised based on different occupational sectors, the various schemes envisioned for each sector originate notable distributive disparities among sectors.

1.4.2. Reform Trends

Taking into account the above-mentioned intrinsic Bismarckian-pension regimes' problems, one may identify multiple broad trends in the reforms implemented by social insurance countries since the late 1980s and early 1990s.

First and foremost, requirements needed for one to receive a full pension were tightened by altering the respective benefit formula: for example, all contribution years were taken in analysis rather than only the "last years" or the "best years". At the same time, non-contributory years were eliminated and lower pensions were granted to those with a less full employment record.

As far as financing is concerned, the late 1980s saw the initial stages of a transition towards implementing a defined contribution system: even though PAYG mode of

[26] Schludi, *The Reform of Bismarckian pension regimes*, 47.

financing was not going to be abandoned, a sort of funded scheme was gradually introduced.

Furthermore, a common trend of reform concerned increasing the age of retirement, consolidating a binding age retirement and gradually shifting away from both early retirement schemes and preretirement pathways. In fact, the idea that early retirement for older workers would have incentivised full youth employment soon disappeared. A halfway solution consisted of giving workers the opportunity to combine part time work with partial pensions, even though this involved a limited number of categories; many others received incentives to stay in labor force beyond the newly institutionalised standard retirement age.

Within this tightening and restraining path, the widely popular custom to having created special pension schemes for specific occupations was rejected and no furtherly differentiated reforms were promoted. Moreover, countries were granting a basic pension, regardless of individual needs, started to either fully or partially take into account other retirement incomes.

For the first time ever, unpaid family work was included into the benefit calculation: childcare assistance activities and frail elderlies' assistance were both in higher benefits' calculations. Interestingly, these family driven credits are the sole expansionary aspect of this cluster of reforms, in line with the gradual though steady institutionalisation of life stages. These reforms were embraced by countries such as France, Italy, Germany starting from the early 1990s.

Parallelly, increased tax financing of the then existing publicly financed pension was implemented. The reason for this additional subsidy, out of general revenues to the separated public pension schemes aimed at either containing or reversing the then-considered inevitable increases in contribution rates, relieving employers of non-wage labor costs. Such reforms were implemented in Belgium, Italy, France, Germany, Sweden and Japan.

Overall, one may conclude that social insurance-based reformed their systems by reducing entitlements and by lightening the state's burden as to widen the employment of non-public schemes.

1.5. The overall privatization of pensions

1.5.1. The Seminal Contribution of the World Bank

The paradigmatic shift which was registered in the late 1990s and early 2000s in many Western European countries, particularly in those featuring publicly financed PAYG pensions, may be summarised in the overall attempt to move towards the privatization and marketization of pension systems, implementing a multipillar pension architecture envisioning more space being given to either prefunded or funded elements.

This was believed as to entailing a fostering of pre-funded supplementary pensions, either mandatory and/or voluntary, in order to reduce the states' involvement in granting pensions to unbearable demographically changing societies. The final aim was to reduce, contain and retrench public pension expenditures.

The path undertaken by Western Europe, in terms of reform, experienced a turning point in 1994, year in which the World Bank published what has been considered as a revolutionary contribution, that is the report *Averting the Old-Age Crisis: Policies to protect the old and promote growth.*

The latter deserves attention for different reasons: on one hand, it represented the first time in which the concept of dividing pension schemes into pillars was proposed; on the other hand, the multi-pillar concept was structured into three distinct pillars[27]. Before moving to the effects of the World Bank's publication, this paper will proceed with a thorough assessment of the three pillars, as interpreted in the Report.

The background from which the World Bank experts drew on was made up of multiple pension concepts: the Bismarckian, the Beveridgean and that elaborated by both Friedman and Piñera. Starting from the widely recognised global challenges undermining the existing generous pension systems, as the unfavourable demographic tendencies and the increasing life expectancy along with the economic downturns of numerous economic shifts, the World Bank experts convened the financial unsustainability of the widely

[27] Poteraj, *Pension systems…*, 65.

spread PAYG systems. In addition, as to the financial sourcing of pensions, greater diversification was identified as more suitable.

First of all, the Report distinguishes among: a first mandatory pillar, "acting as a public programme financed from taxes and aiming at poverty prevention", a second mandatory pillar "connected with capital markets, managed by private companies, and based on individual savings accounts or plans related to employment" and a third pillar, which is "voluntary, supplementary, also connected with locating assets on capital markets, and implemented in the form of personal savings or plans related to employment"[28].

As far as the first pillar is concerned, its mandatory public nature is perfectly in line with the World Bank's continuous emphasis on the need to protect the elderly against absolute poverty. This should be reached via a flat pension for everyone rather than via means tested benefits. The reason for this to be stressed lies in the need to protect the elderly, especially in developing countries, in which at the time of the Report's publication, featured large inequalities in the distribution of wealth. Within such a context of inequality, the elderly would have suffered the most if the no emphasis were carried out on the need for the government to provide a basic flat pension to all, regardless of one's income.

As far as the second pillar is concerned, a large literature followed the World Bank's prescriptions on how this should be structured. Overall, one may define it as a privately though mandatory or quasi-mandatory supplemented plan, granting benefits only to its contributors. It was envisioned as linked to an employment relationship, made up by employers and/or employees, supported via tax advantages[29]. They are usually established through employment contracts, aided by social partners based on collective agreements. The difference between the first and second pillar is substantial: the former was thought as a non-contributory flat pension, granted to all in order to avoid absolute poverty whereas the latter envisioned a contributory-based pension, that is the ones contributing more would have been granted the most[30].

[28] Ibid.
[29] Eatock, "European Union pension systems. Adequate and sustainable?", 2.
[30] Willmore, "Three Pillars of Pensions? A proposal to End Mandatory Contributions.", 1.

As far as the third pillar is concerned, it was set as a prefunded private voluntary supplementary plan, available to those who would be willing to supplement even more the benefits provided by the first two pillars. In other words, it marked the creation of personal pensions, whose contributions are invested in an personal and individual account, managed by either a pension fund or a financial institution. This practice may be sometimes tax-incentivised[31].

The World Bank had not been the sole institution advocating for the introduction of private funded pensions. Since the late 1980s, the Organisation of Economic Co-operation and Development (OECD) had been publishing numerous reports on the issues causing the financial unsustainability of the then-existing pension systems, as the 1988 "Population Ageing: Economic Effects and Some Policy Implications for Financing Public Pensions" Report.

The latter marked a turning point in the institutional recognition of the impelling demographic issue featuring OECD countries, that is a dramatic reduction in growth rates followed by an increasing number of elderly whose expectations of being granted an adequate pension were going to be fulfilled. However, due to its limited impact on channelling national policy developments, its main role was that of providing statistical information.

At the same time, one must underline the two European Union directives on pensions and pension systems, in force before 2000: the Council Directive 96/97/EC of 20 December 1996 establishing equality between women and men in providing them with social insurance as employees, along with the Council Directive 98/49/EC on 29 June 1998 recognising the need to supplement further pension rights to both employed and self-employed people moving within the Community[32]. To this regard, the year 2000 marked the beginning of what is called Open Method of Co-Ordination (OMC) in pension systems, envisioning that each Member State would and could carry out individual decisions on what pension system to implement though given that all Member States were facing similar issues, it advised the implementation of coordinated reforms aimed at sustainable and long term growth rather than isolated reforms.

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[31] Eatock, "European Union pension systems…", 2..
[32] Poteraj, *Pension systems…*, 73.

Within this context, since the late 1990s the European Monetary Union had been even more stringent in limiting the fiscal capability of governments' promises on non-funded pension rights. As one may infer from the above-mentioned internationally supported interventions and more or less poignant advices, policy experts were suggesting to shift away from public PAYG pensions towards more private, mainly prefunded pensions, in order to make pension systems more financially sustainable in ever-growing ageing societies, increasingly pressured by fiscal austerity and by difficulties in encountering the measures which would lead European countries to the much needed economic growth.

1.5.2. Varieties of Funded Pensions

When dealing with the privatization process, one refers to a transformation entailing, as already stated above, a shift towards a multipillar system which implies the expansion of reliance on privately funded pillars. To this regard, one must note the subsequent shift, within the funded pensions themselves, from defined benefit to defined contribution plans. This process leads to a gradual decrease of the state's liability which, in such privatized system, becomes solely responsible for providing basic entitlements aimed at poverty prevention.

As noted in the previous paragraph, international pressures and domestic challenges led to a massive shift towards privatizing pension systems: between 1988 and 2008 twenty-nine countries implemented systemic reforms establishing mainly non-governmental, that is non publicly managed, funded pension systems. Among many, one may mention reforms passed in Sweden, Poland, Croatia, Slovakia, Bulgaria and Romania.

As it will assessed in the following chapters, Eastern European countries were the ones to majorly implement fully fledged prefunded pension schemes whereas Western and Southern European countries chose a more path dependent trend and have undergone a more difficult transition towards a full embrace of private funded pensions.

In general terms, Western European countries' "public schemes were subjected to cost-containment via a number of measures such as, for example, stricter links between contributions and benefits, higher pensionable ages and the lower indexation and valorisation of benefit".[33] This appears in line with the ultimate desire of achieving a full or partial replacement of publicly financed social insurance systems with efficiently administered systems based on private and voluntary savings.

Overall, within this shift towards funded pensions, in their defined contribution form, a reason for which the latter have been privileged has been their alleged advantage of being fairer and more transparent in terms of financing, therefore leading to more diversified risks rather than to the sole public pillar related one. In addition, it should be noted that private funding once again alleviates the public financial burden. However, exposing contributors to higher individual responsibility supposed or at least, does require major financial knowledge and skills on each individual's part.

Nevertheless, despite such downturns, funded schemes were seen as the sole valid alternative to the dramatic demographic transition, triggered by progressive ageing (resulting of an increasing life expectance and low fertility rates). Contrarily to widely spread PAYG systems, greatly dependant on demographic trends for previously mentioned reasons, funded pensions appeared as "less prone to demographic developments"[34].

One must underline that even though many European and non-European countries have shared the goal of reaching funded pensions, this goal was not reached homogeneously. Each country traced and then implemented a specific version of defined contribution plans, within the funded pension scheme broader arrangement. There is no single defined contribution plan model, as many different versions have emerged throughout the decade going from late 1990s to late 2000s. The distinction put forward by Börsch is extremely useful to grasp the basic guidelines followed by a vast majority of countries.

A classification of funded pensions established during the decade in analysis is founded on the initial introduction of such schemes as promoted by the state itself. The

[33] CESifo Report, 32.
[34] Börsch, "Many roads to Rome: Varieties of funded pensions in Europe and Asia.", 172.

first step undertaken by national governments consisted in partly funding their public pension pillars through Pension Reserve Funds (PRFs). The latter were set very similarly to defined contribution plans: the goal was to accumulate as much savings as possible in order for them to be used to cover future expenses, leading the government to also reduce its liabilities.

PRFs' success is tightly linked to their opportunity of providing a safety net in terms of demographic change. Their role may be compared to that of a buffer zone, given their aim to prefunding a part of the future payments which will need to be delivered in a PAYG system. Once the ratio between employees and pensioners became unfavourable for the former, the pension system envisioned drawing from the savings and capital accumulated in the PRFs without requiring an increasing amount of contributions from the already highly taxed employees[35].

An equally important level of introduction of funded schemes has been that of work-related pensions. Within the broad group of defined contribution plans, a further distinction lies in terms of participation, in fact this may be either mandatory or voluntary.

Mandatory funded occupational/work-related plans are not traditional occupational plans being they are usually financed for the most part through social security contributions thus foreseeing the employer's sole indirect involvement. Despite such minor role, employment does occur as an eligibility criterion. In terms of diffusion, these have been majorly implemented in emerging economies whereas the voluntary personal plan typology has been popular in more developed and structured economies, as the ones featuring Western Europe. As far as the voluntary personal plans are concerned, these greatly differ from the traditional voluntary work-related plans which involve the employer's participation.

On the contrary, voluntary funded plans are 'tax-favoured retirement savings purely at an individual level therefore no space of action is left to an employer. Interestingly, mandatory workplace related funded pension plans may be encountered in most Central European countries.

[35] Ivi, 175.

Along with the mandatory-voluntary distinction, Börsch portrays a further classification based on the opportunity to effectively carry out an individual investment choice: that is, the extent to which each member may invest his or her own savings reflecting their true preferences though of course increasing the financial risk, given a supposedly average knowledge of investment tactics.

Chapter II: Transformation of Pension Systems In Eastern Europe

2.1. Institutional legacies: The Socialist Social Security System

2.1.1. The Austro-Hungarian Influence

Eastern European countries have had a long-lasting tradition of social insurance, dating back to the Austro-Hungarian Empire. These countries established different forms of the Bismarck-style pension linking benefits to a specific professional status. This link was equally strong in Central Europe, South-Eastern Europe as well as part of the Austro-Hungarian Empire and the Baltic States, neighbours of Bismarck's Germany[36].

At the beginning of the 20th century, in the years 1906-1933, pension schemes were based on a corporatist vision of social solidarity aiming to secure occupational standards along with reproducing professional achievements. Pension benefits were earning-related and depended on the payment of pension insurance contributions thus producing a highly non-egalitarian system. Moreover, its quasi-compulsory nature in terms of participation, induced segments of the population to remain uninsured.

The management of the social security system was decentralised so primary responsibilities were given to the local level of administrations, that is local communities or workers' associations, which had the duty to ensure a minimum level of substance to their members[37]. Similarly, old-age protection was handed to the latter. Its main financing

[36] Cerami, "Ageing and the politics of pension reforms in Central Europe, South-Eastern Europe and the Baltic States.", 333.
[37] Cerami, "Ageing and the politics of pension reforms…", 335.

mechanism was via social insurance contributions, aimed at covering individuals against risks associated with old age and health. There was also a safety net for the poor, either state or charity-financed, though insufficient at guaranteeing minimum living standards rather useful to temporarily alleviate extreme poverty.

Interestingly, the first significant developments occurred after the end of World War I: health, accident and pension insurance regulations were implemented in many Eastern European countries. What deserves attention is the role played by the Great War in boosting the creation of separate insurance branches, from this point on developed independently and differently.

2.1.2. The Soviet Occupation

Massive changes were implemented following the Soviet occupation in the aftermath of World War II and its consequent attempt to shift towards central planning. This did not entirely abolish the dominant Bismarckian mode of access to benefits. Contrarily to that time’s expectations, it was expanded in line with the communist egalitarian aspirations.

The main characteristics of the Soviet Social security system were: a generalisation of the schemes, a broadening of the coverage to include the whole working population, a financial merging of the state and the social security budget, no unemployment insurance and a separation of national health services. The main socialist social policy instruments were full employment and price subsidies for goods and services.

Furthermore, social insurance system’s financial autonomy was abandoned by including social expenditures in the state budget, contribution revenues were part of the more general tax revenues and a separate social insurance budget, in which neither deficit nor surplus were calculated being that the contribution rates remained more or less stable for a long period, was introduced. Contributions were paid almost exclusively by enterprises, employers and administrations, as employee contributions were rare.

Contributions were calculated on the basis of the employee's total income and no personal accounts were held: the enterprises had to pay the contribution rate for the whole payroll.

As far as the benefits were concerned, a massive gap between individual contributions and individual benefits continued to grow, being that pensions were calculated based on the years of service and the income of the last years before retirement. Additionally, benefit entitlement was featured by an extremely low retirement age, lower for women than for men. The official retirement age for men was 60 years, whereas for women between 53 and 60 years. Average replacement rates were considerably lower than international standards, amounting to approximately 40% of the former income[38].

Pension benefits continued to be based on an occupational basis. Despite all citizens being formally employed and differences among wages were extremely low, benefits tended to be universal in their scope, lacking to take into account each individual's needs. Some exceptions did exist: professional groups linked to the communist party structure were certainly privileged (politicians, party apparatus members and enforcement branches).

Predictably, the typically differentiated-scheme Bismarckian model was put under control with social insurance revenues and expenditures becoming an integral part of the state-controlled and planned economy. Participation in the social protection system was compulsory, its management was deeply hierarchical and followed a top-down approach, as the Ministry of Social Affairs was the sole responsible to plan relative policies. These were implemented at local levels, though following strict instructions coming from indications originated at the central level, often lacking knowledge of local needs. By contrast, access to welfare benefits was granted exclusively on the basis of the discretion of local officials[39].

Overall, pension systems' coverage was enlarged in order for them to become the final pillar within the social system's promise for minimum income and achievement of decent living standards. The first pillar was support for families, in the forms of universal family benefits, childcare, education and health services, among others. The second pillar covered the working life and the belief of granting each individual a job, based on his or

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[38] Schmähl and Horstmann, *Transformation of Pension Systems in Central and Eastern Europe,* 34-35.
[39] v.40

her skills whereas the third involved the assignment of a pension, with almost complete salary replacement. Together, these assured secure income to households.

Along with the above-mentioned features, one may mention that all Eastern European countries had only one, publicly managed, redistributive system which excluded any other pillar, no matter the existing different governmental apparatuses.

The reason for this is to be found in the establishment of central planning, that is all finances were handled by the state which prohibited the foundation of any demand for longer term financial intermediation. The richer households, capable of generating personal savings, did so by owing to the shortage of consumer goods to buy. These personal savings were usually held in private banks, with extremely low interest rates.

Furthermore, all Eastern European countries reached a quasi-universal coverage, especially after the collectivisation of agriculture, which allowed for the inclusion of the previously partly excluded agricultural sectors, whose members were all forced to join cooperatives, here as well managed and coordinated by state para-organisations.

Additionally, soon after the beginning of the Soviet occupation, old-age insurance schemes were unified with other short-term insurance programs, envisioning only one contribution rate. Interestingly, it has been pointed out that many Eastern European countries did register surpluses in the late 1970s and early 1980s, though these were not held in fund but were used by central governments for these to source their deficit finances[40].

2.1.3. The Impact of Low Retirement Age

Special attention deserves the extremely low retirement ages in place throughout Eastern European countries: as previously mentioned, prior to the collapse of USSR, the normal retirement age was 60 for men and 55 for women. However, an even lower age

[40] Fox, “Old-Age Security…”, 4-5.

was set for special occupations, such as heavy industry workers or miners, for which full pension was granted at the age of 45 for women and 55 for men.

In order to grasp the huge financial impact that such low retirement ages had on the states' budgets, the case of Poland serves as optimal example. In fact, in 1990 40% of all age pensioners were below the standard retirement age, considered to be about 57 for men and 53 for women. Being that at age 60, women were estimated to have a life expectancy of over 19 years whereas men to have one of 16 years, this led to a post-retirement life of over 25 years, predictably unbearable from a fiscal perspective.

Consequence of the extremely low retirement ages worsened also as a result of post-war demographic trends. Conversely to OECD countries, in which system dependency is only 8% higher than demographic dependency, in most Eastern European countries rates range from 30% to 50% higher than the old-age dependency ratio.

One must also mention the high degree of laxness featuring the issuance of disability certificates. Being that it was usually issued by the local doctor, corruption was commonplace. Just to recall cases of grinding issuance: in Bulgaria, 12% of pensions were paid for disability, in Hungary 30% and in Poland, it has been estimated up to over 36% for disability-related causes. Equally worthy of reference is the exemption covering cash transfers of all kind from tax systems[41].

2.2. Multi-phase development of pension systems

2.2.1. The legacy of central planning

The collapse of USSR triggered a triple transition in all Eastern European countries that had been under the socialist rule until 1989. First and foremost, a gradual transition from central planning to market economy was implemented, which of course involved the pension retirement schemes and its new envisioned structure. Parallelly, transition from socialism to democracy and from being part of the authoritarian Russia-

[41] Ivi, 6.

based Soviet Bloc to the European Union, were both major shifts which certainly did start in the aftermath of the collapse, though lasted decades.

One of the main features of the transition was a crisis in pension systems due to the rapidly changing demographic transition and the dependency burden weighing on the working population. Such high and ever-growing expenditures in pension undermined both the stabilization of the newly founded independent countries and the principles according to which other government expenditures could have been administered. The demands of pensioners, which governments promised to fulfil, led to gradual lowering of the real wages of the working-age population, which may have contributed to the growing poverty of households with young children, as previously assessed.

As stated in the preceding paragraph, the legacy of the central planning heavily weighed on the transitioning economies: adjusting the old-age security system required a great efforts to convince the population itself for the need to reform. One may imagine the common perception among the population: in fact, the command economy had granted pensions covering 80% of wages. The main effects of the pre-transition system had been artificial inflation of the dependency burden on working age population, currently considered to have been the root of the pension problems which Eastern European countries are now facing.

As noted by Fox "the post-communist states of Central and Eastern Europe and the New Independent States, with much lower incomes and tax collection capabilities, have promised higher benefits (in relation to their resources) than some of the richest countries in the world, many of which are now finding their generous welfare systems unaffordable"[42].

Within this context, same as other major economic sectors, pensions underwent three main reform phases, up to the ultimate embracement of the World Bank's contested "New Pension Orthodoxy", which will be analysed in depth later in this chapter. In addition to the massive transitions, expected to occur in the entire area, all countries faced an even greater challenge, that of a "demographic transition marked by ageing and

[42] Fox, "Pension Reform in the Post-Communist Transition Economies", 371-372.

shrinking populations"[43]. That is why, a no reform scenario was definitely not taken into consideration: domestic and international requirements forced Eastern European countries to embrace a whole new perspective.

Socialist pension systems were already experiencing financial difficulties prior to the collapse of USSR, their inefficiency and fiscal unsustainability become lethally unbearable once the socialist structure of the system broke into pieces, following the acute labor market crisis which featured the early 1990s. The latter, along with an ageing population to which early retirement was granted, led to the system's final breakdown. To this, newly established post-Soviet governments responded by implementing numerous reforms, which have now been categorised into three distinct phases.

This multi-phase decade long pattern has been divided by Horstmann and Schmähl thus has been identified as featuring three different types of changes, driven by distinctive matrices: changes triggered by economic transformation, a period characterised by changes representing changing social objectives but at the same time hampered by political/economic/institutional barriers and a period in which comprehensive reforms with long-term changing distributional objectives were accomplished[44].

Overall, before the mid-1990s policymakers opted for parametric adjustments, seen as adequate for that moment's precarious economic asset. In this context, parametric pension policy reform will be referred as a process which involves 'changing the existing values of pension program parameters within politically and demographically acceptable limits so as to prevent the size of pension deficit from exceeding tolerable levels determined by governments'[45]. The breadth of tolerable levels may lead to implementation of either a one-and-for-all comprehensive shift in pension reform or multiple gradual changes, however both approaches share the need for them to follow a pre-established time path.

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[43] World Bank, *From Red to Gray. The "Third Transition" of Aging Populations in Eastern Europe and the Former Soviet Union*, 1.
[44] Schmähl and Horstmann, *Transformation of Pension Systems…*, 43.
[45] Sayan and Kiraci, *"Parametric pension reform with higher retirement ages: A computational investigation of alternatives for a pay-as-you-go based system"*, 952.

At the same time, both ways of introducing changes envision parameter values as being compatible with a country's specific deficit, realistic demographic condition, the population's realistic contribution opportunities and were all directed to key features of the PAYG schemes[46].

2.2.2. Waves of reform

As far as the Eastern European pattern is concerned, the first changes were implemented between the year 1989 and 1992/1993, needed and triggered by massive economic changes due to the transformation of the economic system itself. For this reason, pension system adaptations were reactive to changing economic conditions, that is a rising hyperinflation and an undeniably changing labor market.

These adaptations included the introduction of an indexation mechanism (though initially only discussed rather than effectively implemented) along with the implementation of a new form of coverage for self-employed people. In addition, a cornerstone accomplishment was the formal abolition of politically motivated privileges, required to effectively carry out the aspired political transformation[47].

As previously mentioned, in order to adapt pensions to the newly-established market economy, an indexation of pensions – by automatic adjustment – was considered as favourable. Nevertheless, one can distinguish two different types of pension indexation: on one hand, indexation by discretion and on the other, automatic indexation. The former is directly connected to the actual state budget resources whereas the latter type consist of an automatic adjustment to varying economic indicators.

However, such automatic mechanisms do entail both technical and political problems, leading to general discontent along with affecting the political independence of the pension system: above all, underlying critical issue of such automatic adjustment

[46] Muller, "The politics and outcomes of three-pillar pension reforms in Central and Eastern Europe", 87.
[47] Schmähl and Horstmann, *Transformation of Pension Systems…,* 45.

is the level of pensioners' income during times of recession and recovery since instruments of indexation do influence the pensioners' relative income[48].

For these reasons, some of the eastern Europe countries preferred to address this issue by adjusting pensions with lump-sum compensation payments rather than periodically increasing pensions by a certain percentage. Lump-sum contributions were also favoured for their ability to flatten the politically driven discrepancies among different categories along with better coping with hyperinflation, being that previous payments were not individually recalculated each time.

As far as the existing discrepancies are concerned, in line with the massive political changes featuring those years, pension differentiation was no longer considered acceptable therefore lump-sum payments, instead of a percentage rise in each pension, served to equalise all pension payments.

In fact, over the years, countries underwent different experiences with indexation measures and their financial impact brought all the countries to a combined system of wage/price indexing. Interestingly, Poland and Hungary represent two exceptional cases of pension reform even prior to a change in the economic system. Having been the first countries to introduce indexation pensions, pensioners were better off than in the other countries. As a result of such politics, many were able to improve their income compared to the countries' working population.

In contrast, the income position of pensioners in other countries either stayed the same or even worsened. Horstmann and Schmähl's work shows that the measures taken in the first stage of transformation concentrated on the benefits of existing pensioners: there were neither changes in benefit formulas nor in the method of financing, that is in the pensioners' income position or overall distribution.

The second phase of reform is assessed as having taken place between 1992/1993 and 1995/1996, during which there were many small changes aiming at fulfilling new goals in new directions. It has been defined as reflective by Horstmann and Schmähl, for its underlying delay in the implementation of fundamental reforms. Four main developments are considered to have characterised this period: changes in the benefit

[48] Ivi, 46.

formulas, changes in the organisational structure of the pension systems, a growing financial independence and the introduction of a voluntary pension insurance.

As far as the introduction of new pension formulas is concerned, these represent the double task with which pensions systems were confronted: on one hand, they were expected to protect a huge share of population against poverty in times of extremely dramatic economic changes whereas on the other, pension policy was expected to become more market-oriented and capable of adapting to overall newly-established economic asset. In terms of poverty reduction, interesting improvements in terms of redistribution were gradually introduced, being that under the socialist systems, poverty elimination was pursued solely through subsidised prices and planned wages, as well as the right to work[49].

Complementary measures needed especially in relation to differing international standards, were both the retirement age's increase and the extension of the number of years considered as accountable when calculating an individual's pension. One must bear in mind, in order to grasp the importance of such measures, that under the socialist security system pensions were based on the last year or few years' earnings before retirement. The extension of such calculation was considered as capable of creating a stronger bond between paid contributions and the pension itself.

Along with the latter, a third important development is certainly the gradually spreading consensus within the political spectrum of the need to elaborate a separate organisational apparatus in order for it to be also granted the previously lacking financial independence. In the early years of such comprehensive transformation, as the collapse of USSR, newly freed sovereign states were eager to get rid of the all-powerful state, which had installed for decades a single state budget.

Of course, each country accomplished this distancing path in different ways: in Hungary, Slovak Republic and Lithuania administrative separation was accomplished quite soon; Poland had been having a separate social insurance budget since 1986, making it the most advanced country in terms of transformation rapidity whereas Czech Republic

[49] Ivi, 47-50.

and Estonia did elaborate a formal separate social insurance budget though an effective organisational division did not come straight away.

The last important development characterising the period in analysis, is considered to have been the introduction of a second voluntary pillar, particularly in Hungary and Czech Republic, as it will be assessed more in depth in the following chapters. Though the need for an additional private insurance was felt as necessary in all Eastern Europe, a lacking financial infrastructure made it extremely difficult for it to effectively develop. Therefore, countries which were able to introduce and second pillar, did so on a voluntary basis[50].

The third phase of the transformation of the pension system, temporally placeable starting from 1995 onwards, was profoundly affected by the 1994 World Bank principles, stated in the WB Policy Research Report Averting the Old Age Crisis[51], which gave birth to the multi-pillar system, as described in the previous chapter. This was a phase of comprehensive reforms, no longer implemented within the institutional framework prior to 1989. In fact, it was characterised by different political decisions, predictably leading to different outcomes based on each Eastern European country's national context, though sharing a common implementation of a mandatory second pillar.

To this regard, Latvia was the first country to introduce a completely new pension system, elaborated thanks to the assistance of the Swedish World Bank team, reason for which the two systems share many common features. It consisted of a first pillar of designed contribution, constructed as a defined contribution system, and a mandatory and capital-funded though privately managed second pillar. Furthermore, a voluntary induvial saving was supposed to supplement old-age income. The so-called Latvian model was long considered as an ideal and pure version of what other Eastern Europe countries would have been keen to implement, same as the Chilean model is currently a synonym for other Latin American countries[52].

As of the late 20th century, more precisely around 1998/1999, right before the beginning of the privatization process, which will be assessed in detail in the following

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[50] Ivi, 53-54.
[51] World Bank, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth.*
[52] Schmähl and Horstmann, *Transformation of Pension Systems…*, 56 – 58.

paragraph, in most Eastern European countries pensions as share of GDP increased. In those years, pension expenditures reached about 15% of GDP in many Eastern European countries, as Poland and 10% in Hungary, for example. According to Fox, two main factors are accountable for these increases: on one hand, the ability of pensioners to recover most of the previously lost purchasing power.

As most incomes, during the first years of transition, marked by inflation and prince decontrol, pension fell in real terms. However, soon after the prices' stabilization, pensioners were able to recover more purchasing power than wage earners: "the ageing were able to capture a larger share of the falling GDP"[53]. On the other hand, "the policy measures taken by many of the post-communist states to cope with the social costs of transition have significantly worsened the financial position of the public pension system. In hopes of reducing unemployment, countries allowed workers to retire up to 5 years earlier and receive a full pension"[54].

Keeping most pensioners out of poverty, throughout the first decade of transition, was achieved at a high fiscal cost for the states' budgets along with a social cost, greatly damaging families with children, that constitute the growing poverty group.

As mentioned in the previous paragraph, according to eminent studies[55] conducted in those years, households' analyses did show an increase in poverty though pensioners were not pone of the most overrepresented categories. World Bank's 1996 Report indicated two distinct reasons, which slightly differ from those advanced and reported in this paper. On one hand, most pensioners did continue to work, especially in the first decade post-pension: in fact, one must bear in mind the extremely low retirement age.

On the other hand, most pensioners had already access cheap housing opportunities along with starting the difficult transition period having also access to many consumer durables, when compared to younger constituted households. On top of that, it was stated that most pensioners had also access to intrahousehold transfers, due to the fact that most of them were not living alone, by themselves[56].

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[53] Fox, "Pension Reform…", 373.
[54] Ibid.
[55] World Bank, *World Development Report.*
[56] Fox, "Pension Reform…", 374.

2.3. The impetus for pension privatization

2.3.1. The origin of pension privatization

The adoption of pension privatization in Eastern Europe reflected the global trend towards the introduction of privately funded pension funds, initiated by Chile's early successful attempt, dated 1981. The concentration of pension privatization among post-communist countries is surely not coincidental. The assessment portrayed in the previous pages provides a profoundly negative financial context, featuring massive public deficits following decades-long if not centuries-long implementations of costly policies: the completely state-run pension system had become unsustainable.

In fact, Eastern European post-communist countries were facing unprecedented fiscal and demographic challenges, which had been disregarded during the communist rule and that in a post-communist asset had become an unbearable burden. In addition, one must also stress the political and social effects of the then ongoing continuous comparisons carried out by international organisations, as the World Bank, among established market economies in Western Europe and newly founded ones as Central and Eastern European countries.

The latter countries were all facing similar demographic and financial challenges, no longer able to overcome within the inherited communist context. Additionally, the international community was now both offering advice and assistance to the elaboration of innovative measures in the pension systems. To this extent, the role of diffusion will be later assessed in relation to the entire area's sudden shift towards pension privatization.

Even though the overall process of privatization has been already assessed in the previous chapter, given the relevance of the latter process, it appears extremely useful to stress once more the main shift envisioned by the World Bank in a cornerstone publication. In *Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth* the World Bank promoted pension privatization and portrayed in detail the benefits of this new type of system, that is a privately funded pension system.

Conversely to a defined benefits system in which each retired citizens receives a fixed amount of support, pension privatization is a defined contribution system in which each citizens' benefits are determined based on returns to individual private savings.

As previously stated, the focus of this new system was no longer the state rather the citizen, who was now considered responsible for the funding of his retirement scheme. In addition, pension privatization would have also boosted the resolution of each country's broader macroeconomic performance, investments and savings. The World Bank promoted pension privatization as a means to overcome these countries' financial challenges, with the belief that it would shift the financial burden for providing citizens with a retirement scheme away from the state, handing each citizen the responsibility of getting involved in his or her own retirement.

Overall, scholars have also pointed out that when social programs are funded through an accumulation of savings rather than through transfers between taxpayers and beneficiaries (as in typical publicly funded pensions) they can lead to the rise of a huge flow of capital which is thus injected in the system. What Margarita Estévez-Abe calls "welfare-finance nexus" may be considered as strikingly important in the choice to shift towards largely funded systems.

In fact, political protagonists of the time argued that in addition to alleviating the impact of an ageing population, lower fertility rates and relatively slow economic market-oriented policies, a shift in the financing of pension systems would have generated capital thus an inevitable economic boost. Furthermore, one must bear in mind that in poorer capital economies, as the Central European ones in the time frame here analysed, promising major economic boost thus personal savings certainly attracted the support of corporate governance and investors.

Finally, a very interesting approach is that of Naczyk and Domonkos whose article stresses the role played by "domestic coalitional and political-economic dynamics"[57]. Those supporting pension privatization (such as financial firms, finance ministries and

[57] Naczyk and Domonkos, ""The Financial Crisis and Varieties of Pension Privatization Reversals in Eastern Europe", 169.

pro-market politicians) were gradually labelled as supporters of more thorough market-oriented reforms.

Consequently, the implementation of an effective privatization was considered as the ideal solution to address the then-current fiscal imbalances and growing demographic ageing, boost economic growth and easily stimulate greater economic growth.

2.3.2. Main privatization patterns

The reconfiguration of the public-private mix varied across single nations within the Eastern European area therefore making it impossible to thoroughly assess the patterns chosen by every country. At the same time, undoubtedly one may state that the most radical shift within this mix did occur in some Eastern European countries which were the sole ones to implement the then-radical reform already implemented by Pinochet's Chile in the early 1980s and which had yet to receive international attention.

Between the mid-1990s and early 2000s more than thirty countries started replacing their publicly managed pension accounts with mandatory private retirement ones. The model adopted was "a combination of public pay as you go (PAYG) pillar that is sometimes means-tested and a second pillar of mandatory individual accounts, of varying size and importance"[58]. The extent of contributions to the private pillar greatly varied across countries, registering a 10% in Latvia, 9% in Poland to 2%- 5% in countries like Bulgaria, Estonia and Lithuania, among others.

Before tracing some general patterns, it is very useful to stress the interesting rapidity with which a huge amount of post-communist countries (approximately fourteen) more or less suddenly was ready to embrace and implement a radical reform as pension privatization: in fact, the latter were able to partially or fully privatized their social-security-type pension systems and implement systems of individual, private pension savings.

Along with other radical reforms, privatization is one of the most shockingly radical institutional changes that a country may undertake therefore it is usually object

[58] Arza and Kohli. "The Political Economy…", 256.

of great domestic contestation which, in the case of Eastern European countries, should have slowed down the process of embracement and implementation. As stated by Appel and Orenstein research "pension privatization radically alters the social contract in place since the end of World War II in most countries, in which current workers fund the retirement of current retirees. It places the onus on personal savings and often is far less redistributive.

Pension privatization tends to reward those with high incomes and consistent, long term work histories. It often is introduced in an effort to control the costs of state-managed social security systems and therefore to reduce overall replacement rates"[59]. Having said this, the striking rapidity with which fourteen countries implemented domestically divisive reforms appears to be an interesting aspect linked to the process thus analysed in a separate paragraph here below.

Overall, the vast majority of countries decided to implement mandatory funded pensions of the defined contribution type. The first country to do so was Hungary, which started in 1998, followed by Poland in 1999. Similarly, Estonia and Latvia implemented the three-pillar World Bank based pension reform in 2001 and 2002 respectively, followed by Croatia and Bulgaria which both reformed their systems that same year.

The most recent reforms were implemented in Ukraine (2003), Lithuania (2004), Slovakia (2005) and Romania (2007)[60]. Among these, crucial differences are related to the investment choice given to pensioners: "in Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia, pension funds can or must offer funds with different risk profiles"[61] contrary to those in other Eastern European countries which are allowed to offer a single fund.

To this regard, the case of Slovakia appears to be extremely interesting pension fund members are monitored and assisted throughout their lifecycle. In fact, at an early age, pension fund members are free to choose which of the three funds offered they would like to join. Surprisingly, "when they are fifteen years away from retirement they can no

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[59] Appel and Orenstein, "Ideas Versus Resources: Explaining the Flat Tax and Pension Privatization Revolutions in Eastern Europe and the Former Soviet Union", 128-129.
[60] Schneider, "Reforming Pensions in Europe: Economic Fundamentals and Political Factors", 296-297.
[61] Börsch, "Reforming Pensions in Europe: Economic Fundamentals and Political Factors", 176.

longer be enrolled in the fund with the highest equity share. Seven years before retirement, they are obliged to switch to the conservative fund with no equity exposure"[62].

Among all Eastern European countries, the case of Czech Republic is interesting due to its apathy in implementing radical reforms. The latter did modernize its pension system in the early 1990s, soon after the collapse of Soviet Union, by separating it from the central budget, increasing retirement age and making pension benefits more dependent on individuals' contributions. In 1994 it implemented the previously described parametric measures along with creating a separate voluntary private pension fund becoming a true forerunner. Unfortunately, after a 1996 pension system reform it halted the process leading to a dangerous and damaging apathy.

Furthermore, in terms of expenditure projections, data shows that pension expenditures are envisioned to remain stable in Estonia at about 7% of GDP. Expenditures will fall in Poland from 14% of GDP in 2004 to some 9% in 2050. On the other hand, pension expenditures will rise to 17% of GDP in Slovenia and to 15% in the Czech Republic'[63] for reasons that will be furtherly assessed.

As previously assessed, pension privatization came in many different forms; countries like Kazakhstan and Kosovo fully and immediately replaced their social security systems, introducing individual based funded pension savings account, same as in Chile.

In order for the privatization wave to quickly take place, the role of the World Bank and other International Financial Organization was fundamental through the creation of a high-profile network of international officials capable of promoting and advising involved countries' officials in the reform's successful and effective implementation. Along with massive financial resources donated to pension privatization advocacy network, reforms were quickly implemented. As previously stated, Kazakhstan was the first post-communist country to fully privatize its social security system, followed by Hungary and Poland.

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[62] Ibid.
[63] Schneider, "Reforming Pensions…", 297.

The latter opted for the partial either elimination or reduction of the social security contributions which were transferred to individuals' accounts, greatly limiting the state's involvement due to the creation of newly funded private funds. Both countries gave their citizens the chance to freely invest in multiple and different funds. At the same time, other countries fostered that same freedom to the chance of participating to the new private system[64].

2.3.3. The importance of diffusion

As assessed in the previous paragraphs, between 1980 and 1999, approximately 59 countries decided to opt for a private pension reform, with a most powerful impact in Central Asia and Central Eastern European countries. Due to striking correlation in terms of timing and location within these global-based shifts, scholars have raised many questions and issues on the reasons underlying such phenomenon and many studies have been carried out.

The present dissertation has chosen to take into analysis Brooks presented research and due to the breadth of the argument and the impossibility to correctly portray it thoroughly, one will solely address the main discoveries and the general theory proposed by the above-mentioned author.

First and foremost, diffusion here refers to the "process by which an innovation is communicated through certain channels over time among the members of a social system"[65]. A core concept within the diffusion theory is that of "interdependent decision making", that is each country is at some degree partially conditioned by the choices made elsewhere in terms within that specific social system. Main drivers behind public policy officials are multiple: uncertainty, competition (reputation and status maintenance).

However, when looking when and where the privatization impetus took place, these have been considered insufficient by scholars. In fact, Brooks goes through the

[64] Appel and Orenstein, "Ideas Versus Resources…", 129-130.
[65] Rogers, *Diffusion of Innovations,* 5.

difficulties and disincentives encountered by policy officials in the proposal and implementation of privatization reforms. The latter will be briefly address here below.

Funded defined benefit contributions are domestically costly being that they lead to a direct loss on large portions of the government's electorate, promising distant future benefits thus destroying the political career of all politicians promoting such privatization reforms. As Pierson interestingly points out, politicians "will seek to avoid blame for such losses either by obfuscating benefit cuts altogether, or by enacting them through broad multiparty legislative coalitions that spread political responsibility widely among multiple political actors"[66].

However, in the case of pension privatization, the mobilisation against the latter was highly visible, making it very difficult for the political actors promoting it to effectively blame other actors. In addition, as it will be furtherly assessed, the degree and the manner according to which reversals might have been implemented would have greatly varied, enhancing even more the sense of uncertainty and rejection within the population and future pensioners.

Furthermore, funded benefit contributions (FDC) are also financially costs for governments and countries implementing such reform: the diversion of contributions to privately managed funds, leaves governments without one of the most important sources of revenue. On one hand, the latter does reduce the financial burden of providing for the ongoing pensions, on the other, especially in PAYG systems, it does leave them without an important source of liquidity.

Moreover, one must also take into consideration the political and financial panic in the case of unsuccess driven by a problematic transition towards FDC reforms. Therefore, as stated by Brooks, "FDC pension reform thus entails very high costs that are difficult, if not impossible, to recover later"[67].

Having outlined the above difficulties, Brooks portrays a thorough comparative political study involving the 59 countries which carried out in different timing and manner) some degree of pension privatization. The results of the empirical analysis are

[66] Pierson, "Coping with Permanent Austerity", 415.
[67] Brooks, "When Does Diffusion Matter ? Explaining the Spread of Structural Pension Reforms Across Nations", 706.

strikingly interesting: Brooks highlights the role of peer dynamics, that is "the presence of a forceful interdependent logic shaping the adoption of structural pension reform"[68].

Even though multiple variables are considered as impactful, the former is truly the one able to explain the timing and the rapidity with which a large number of countries decided to adopt such a difficult and controversial structural reform. "Policy decisions made by peer governments reveal systematic influences on the pension reform decisions by governments"[69].

At the same time, the coefficient variable concerning the role of the "hard power" is limited. Therefore, the hypothesis according to which international financial organizations might have obliged via massive financial aid, the implementation of privatization reforms: international economic pressures were not the predominant root in the choice of 59 countries shifting towards an undeniably hazardous reform.

Predictably, the variable linked to demographic change is important and impacting across all countries, leading to a positive assessment in terms of driving the success of the structural reform here discussed. In line with the demographic component, Brooks points out clearly emerged features of the domestic political spectrum within the adopting countries: those presenting a highly fragmented and shared spectrum along with strong democratic freedoms are less likely to implement privatizing reform in all its components.

2.4. Variations in privatization reversals

2.4.1. Causes of reform reversal

The gradual though steady pattern towards pension privatization in many Eastern European countries covered approximately nearly three decades, starting from early/mid 1980s. Many reforming countries either slowly or more rapidly, opted for major contributions within the second pillar.

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[68] Brooks, "Interdependent and Domestic Foundations of Policy Change: The Diffusion of Pension Privatization around the World", 286.
[69] Ivi, 289.

The latter trend suddenly halted in 2008 concurrently with the global financial and economic crisis which triggered major destabilization in the economies of Eastern European countries. These "had to cope not only with the economic recession but also with financing significant pension privatization transitional deficits, which in 2010 equalled 1.1 percent of GDP in Estonia, 1.2 percent of GDP in Slovakia, 1.4 percent of GDP in Hungary, 1.7 percent of GDP in Poland, and 2.3 percent of GDP in Latvia"[70].

Facing the above described severe fiscal strains, several reforming countries decided to decrease the coverage and extent of pension contributions channelled to the second pillar, giving birth to a second trend, defined as the pension privatization reversal. As pointed out by Whitehouse: "the main cost of pension reform reversals is borne by individuals in the form of lower benefits in retirement"[71].

The underlying reasons of reform reversal are multiple and highly debated, given that scholars have not agreed on the predominantly aggravating cause which led to the reversal trend. In fact, current literature emphasis different aspects and pressures exerted by several distinct institutions.

Most of the explanations concerning reform reversal stress the highly challenging pressure following the 2008 global financial crisis. However, scholars such as Kay, Schwartz and Arias first and foremost point out to the disappointing performance of the second pillar, poorly managed, which must be taken into account, despite the financial crisis striking worldwide.

Parallelly, scholars have also indicated the asymmetrical treatment among impression pension debt and explicit public debt in the EU Stability and Growth Pact as one another major factor in causing privatization reversal. In fact, the latter has appeared to be more easily justifying rather than within the overall economic context: the former is considered as more manageable given its junior existence.

For this reason, EU fiscal rules and regulations seem to have incentivised the reversal itself: "Eastern European governments had initially understated and neglected the issue of transitional deficits during the preparatory stage of pension privatization. This

[70] Altiparmakov, "Another look at causes and consequences of pension privatization reform reversals in Eastern Europe", 227.
[71] Whitehouse, "Reversals of systemic pension reforms in Central and Eastern Europe", 17.

gave rise to a predominantly debt-financed transition in many countries and lead to the conversion of accrued implicit pension debt into explicit public debt"[72].

According to a distinctive strain of literature, such debt-financed transitional implementation of privatized second pillar contributions was largely ignored by EU regulations thus encouraging the compliance to then-current European fiscal constraints via some form of reform reversal. However, EU fiscal regulations are considered to have penalized in the terms of not having stressed the importance of implementing austerity measures to these carve out pension privatization trend in the first place.

To this extent, the Chilean case appears to be strikingly exemplifying: the set of fully privatizing reforms carried out at the beginning of the 1980s was accompanied by a "strict and long-lasting austerity measures that produced a surplus of 8.5 percent of GDP in the non-pension part of the public sector over the 1981–2004 period"[73]. On the contrary, other reforming countries which were not able to carry out complementing austerity measures resulted in the above-mentioned debt transitions which inevitably led to large issues in Government bonds and consequently in the portfolios of pension funds.

Therefore, EU Stability and Growth Pact may be considered solely as only one factor, more specifically as a catalyst, that led to the implementation of a massive trend of reform reversal rather that the major cause. In fact, experts stress that if Eastern European countries had complemented the privatizing reforms with austerity measures capable of avoiding a debt-transition, pension privatization would have not been greatly penalized under EU fiscal rules.

Finally, along with the above mentioned economic and fiscal pressures, scholars as Orenstein put forward ideational based change as an additional explanation behind the reversal implemented by Eastern European countries. When examining the pressures exerted on national government, he does partially acknowledge the role of international financial institutions yet also stressing the defeat of pension privatization in the United States and major decrease in Chile at the end of 2000s as very significant drivers within the reversal trend. The latter led governments to inevitably reconsider the benefits of pension privatization, enhancing its consequent costs. All the above conjecturally

[72] Altiparmakov, "Another look at causes…", 230-231.
[73] Ivi, 231.

coincided with the 2008 sever global financial crisis, which catalysed even more multiple reasons drivers.

2.4.2. Consequences of reform reversal

Reform reversal, as earlier described for the privatization trend, has been extremely diversified across countries thus it is very hard to delineate a single process of reversal. Given these differences in carrying out privatization reversal, its consequences are naturally different and varying on a single nation basis.

Existing literature reflects the debated consequences of reform reversal: on one hand, a strain of scholars as Egert, Price, Rudolph, Schwartz and Arias suggest that reform reversal will constitute a burden for future generations, heavily impacting the chances for future young generations to carry out a sustainable economic and financial growth and personal enrichment.

On the other hand, an eminent scholar as Altiparmakov estimates that this is not going to be necessarily the case. In fact, the latter point out that reversal could actually improve pension system in an efficient way especially in Eastern European countries, which carried out a debt financed transition towards pension privatization.

Following Altiparmakov's interesting distinction among different patterns of reform reversal, one must differentiate between: "the Polish type of partial reversal aimed at eliminating disguised PAYG financing, partial or complete reduction in the second pillar contribution rate and moving from mandatory to voluntary second pillar participation"[74].

Given that the present thesis will thoroughly analyse the Polish case, attempting to highlight its peculiarities, one will here trace the patterns followed by other Eastern European countries as Latvia, Lithuania and Slovakia, to some extent.

Among the major decisions taken as to effectively carry out privatization reversal and gradually, one may point out to the scaling down of the second pillar: in fact, Latvia

[74] Ivi, 233.

decided to transfer funds from negatively performing second pillar accounts to positively performing first pillar NDC accounts. According to many scholars, this type of process is not very likely to impact future generations' economic performances and fiscal pressures. In addition, it also permanently reduced the extent of PAYG contributions to second pillar along with allowing to being reinvested in government bonds, considered as secure in the long-term.

To this extent, the above-mentioned countries have also given the chance to workers themselves to autonomously decided whether to transfer their second pillar assets to the state and to return to a fully covered PAYG system. Despite undeniable political and propagandistic reasons, one must necessarily point out how unusual this is and how rarely this has been opted for in western European countries: in fact, there are no traces of pension systems envisioning the worker and/or future pensioner to freely choose his/her own pension system.

In particular, economic literature and empirical evidence suggest that "an average citizen can hardly be expected to make a rational, welfare-maximizing decision in this case, not just because of lack of financial literacy but also because the outcome would be to a large extent endogenously determined by the political process and the behaviour of other participants"[75]. For these reasons, the latter decision has been heavily criticized and is currently debated. According to Altiparmakov, participants should not be given the opportunity to choose whether they want to participate to second pillar accounts rather than being subjected to Western oriented PAYG system.

[75] Ivi, 234.

Chapter III: Case Study: Poland

3.1. The Polish pension system prior to 1989

The Polish pension system and its transformations throughout centuries is undoubtedly an interesting example of the historical and political evolution of the country itself. The territorial annexations and evolutions are not going to be assessed here due to lack of pertinence to the subject, however one must recall very briefly that before the 1921 March Constitution, there was no comprehensive regulation covering social security. In fact, the beginnings of the Polish pension system do date back to the second half of the 19th century though differing based on the legal regulations of each then-occupying country.

The Austrian, Prussian and Russian legislations and regulations applied to their respective occupied polish territories. As far as the Austria-occupied part was concerned, a legislation on civil servants and soldiers was issued in the mid-1870s whereas the Prussian area featured pension insurance for manual workers and white collars, some benefits for clerks and to some extent, company schemes and life assurances were partially operational. On the contrary, the Russian-occupied part did not have a fixed regulation except for the Zagłębie Dąbrowskie Region, in which each mine had its own local system.

Such a differentiated and fragmented system was overcome in 1927, year in which the first Polish comprehensive regulation on social security took place. This was made possible following the promulgation and implementation of the 1921 March Constitution, adopted by the Second Polish Republic after ousting the occupation of the German and Prussian forces in 1918 and by avoiding the Soviet conquest in the 1920 Polish-Soviet War.

The above-mentioned regulation concerned especially white-collar workers, paid by both the employer and employee with the latter's sharing increase based on his/her rise in terms of salary from 0% to 60%. Given the focus on white-collar workers, the

White Collars Workers Insurance Institution was set up in Warsaw in order to administer the White-Collar Workers Pension Insurance Fund.

In addition, it included an initial delineation of an old-age security scheme, later implemented in 1934 with the Act on Social Insurance, formulated in 1933.The "Unification Act", an alternative name given to the 1933 Act on Social Insurance, set the retirement age at 65 and envisioned that in case of exceedance of the latter age, one could request a special benefit called the disability allowance. Similarly to what had already happened in 1927 (benefiting white collar workers), the Blue-Collar Workers Pension Insurance Institution was set up to administer the Blue-Collar Workers Pension Insurance Fund.

However, this was quickly abolished along with the White-Collar Institution in pursuance to an Amendment 1934, in the place of which the Social Security Institution (*Zakład Ubezpieczeń Społecznych*, ZUS) was established. The latter took over managing indistinctively both the White-Collar Workers Insurance Fund and the Blue-Collar Workers Pension Insurance Fund.

Starting from the early 1940s, the Polish social security system experienced a proliferation of Acts and related amendments, frequently circumscribed to single categories (such as farmers, miners, state employees etc) contributing to the creation of severe instability and uncertainty. To this extent, the 1940s themselves saw three major transformations: in 1944 new acts on social insurance were issued mainly abolishing most provisions included in the precedent acts. However, the ZUS was preserved as well as both the blue collar and white-collar workers pension funds.

Similarly disruptive, in 1945 an act was passed which changed the method for collecting contributions: the latter were no longer shared by employers and employees being that employers were now being obliged to pay all contributions in full. Soon after, in 1949, another transforming act was passed which changed once again the method and management of contributions' collection: there would be a single institution (ZUS) to manage a fund, which would collect all the contributions from health, accident, and pension insurance[76].

[76] Poteraj, *Pension systems in 27 EU countries,* 296-297.

Predictably, as the Soviet penetration became increasingly heavy, previously existing polish republican systems and procedures were abolished. "In the Act of 1950 on the Social Security Institution, it was stipulated that this institution will perform all duties regarding social security, except those entrusted with the Employees' Medical Care Institution. Moreover, all other funds connected with social security were closed down, and their capital was taken over by the ZUS. The income and expenditure of the ZUS were incorporated into the state budget, the supervision of which was granted to the Minister for Labour and Social Security"[77].

The eradication of the polish security system continued with a further 1950 decree which "stipulated the abolition of the separate pension systems for the employees of the former local government organizations and the enterprises and factories that such organizations had owned".[78] The apex was reached in 1954, year in which a new law on the universal pension security of employees was implemented. It established the abolishment of the ZUS and changed all existing regulations on old-age income security: all pensions and provisions became under the authority of the Minister for Labour and Social Security.

This was made possible thanks to the previous acts passed in the timeframe 1950-1954 for which contributions of various elements had been merged and the employer was obliged to address all contributions with a single lump sum: in 1950, the social insurance contribution is estimated to have been 15% of remunerations. By the end of the decade, Poland had become a traditional defined-benefit system based on PAYG basis though experiencing the addition of multiple benefits given to specific occupational groups, as miners and heavy industry workers.

Soon after, in 1960, the ZUS was re-founded and the Ministry for Labor and Security was no longer in charge of matters related to pensions (as for their collection, management and provision). Furthermore, one must also highlight the strikingly important reform advanced in 1977 and later implemented in the early 1980s, according the rural population was finally covered by the system. In fact, a separate agricultural fund was set in order for farmers to gradually make up their proper capital: in 1981,

[77] Ivi, 298.
[78] Ibid.

contributions for pension payments are estimated to have been approximately 25% of the remunerations fund.

Equally important, in 1986 the indexation of pensions was introduced and the ZUS was separated from the state budget, anticipating major changes that would have occurred starting from the early 1990s, following the collapse of USSR. Among many, an increase in the number of people collecting a pension payments, the fall in the number of contributions due to a an increasingly higher unemployment rate and a significant increase in the real value of pensions in relation to remuneration, which had reached a level of approximately 38% in 1986[79].

According to scholars, the overall functioning of the Polish social security system until 1989 was majorly negative. It has been addressed as financially insolvent due to many factors: some common to all modern societies in the second half of the 20th century, some shared by other communist-led countries and others intrinsically linked to Poland's societal features.

As far as the first set of factors is concerned, the birth rate fall and a rise in average life expectancy slowly though steadily pressured the system. As far as the second set is concerned, communist led-countries usually feature great pressures on specific occupational branches, which are highly benefited, as stated by Hausner, in the case of Poland, miners and workers in the heavy industry were the ones to gain excessive influence.

As far as the third set is concerned, massive loss of Polish human lives during World War II and the fierce rebellion to Soviet occupation, greatly contributed to an even more slow demographic recovery. Increasing the ratio of contributors vs those eligible for pensions[80]; according to Muller, "between 1989 and 1996 the number of people employed and paying contributions dropped by 14.4 percent"[81].

Finally, it appears interesting to point out another key problem affecting the Polish system: early retirement. Despite a widespread implementation of the latter across many

[79] Ivi, 302.
[80] Hausner, "Security through Diversity", 2.
[81] Muller, "The politics of pension reform in East-Central Europe", 5.

countries, as outlined in the first two chapters, Poland's case is peculiar in terms of causes and consequences, along with a different timing.

Soon after the martial law in 1981 and its related social unrest, authorities attempted to appease some of the population's discontent by introducing massive early retirement scheme for many occupational sectors, though officially presenting it for specific ones and preserving the public schemes in terms of eligible age to retire. However, the actual average age for retirement started dropping year after year. This "led to a dramatic increase in pension system expenditure. Up to 1981 the contribution rate was 15.5% of the entire social security . In the mid-1990s the rate was 45% and was insufficient"[82].

3.2. Designing the new Polish multipillar pension system

The old communist driven scheme, as described above, had been perceived by the population and by the staff of the social security administration as both unstable and unclear, given its continuous amendments, multiple even in a single year. However, Poland had to overcome a two-fold challenge: on one hand, a complex transition from a centrally planned towards a market-based economy which was completed at the end of the 1990s and culminated with Poland's admission into the European Union in 2004; on the other hand, "a transition from a demographic dividend based welfare state to a work effort based regime"[83].

Given the massive macroeconomic transition towards a market economy, rising unemployment, soaring hyperinflation and massive external public debt rates, experts and government officials opted for further encouragement of early retirement In fact, several important occupational branches were included in the newly elected government's policy to favour young workers' retirement in order to alleviate the labor market economy

[82] Góra, "Political economy of pension reforms: selected general issues and the Polish pension reform case …", 7.
[83] Ivi, 8.

pressure. However, by inserting extremely high percentages of young pensioners, pension costs also increased substantially.

For these reasons, several parametric changes were introduced in the early 1990s, including: “lengthening the reference period used for calculating pension benefits from 12 months to 10 years. These could be selected out of 20 years preceding retirement; a reduction of the so-called non-contributory periods that could be considered when calculating the pension to the maximum of one-third of the total insurance history; a 50 per cent reduction in the accrual rate applied to non-contributory periods. Previously, an accrual rate of 1.3 was applied equally to contributory and non-contributory periods; and the so-called branch «privileges» in calculating pensions were phased out. The contribution base used to calculate pensions was capped to 250 per cent of an average salary”[84].

Nevertheless, awareness on the need to reform the social insurance system had been growing since the beginning of the macroeconomic transition: politicians and experts largely shared the need to partly overcome the then-existing PAYG system and to introduce a funded insurance component, in line with the global shift towards pension privatization. However, the then existing stagnation was also politically driven: in times in which high unemployment and great economic difficulties were widespread across Polish population, early retirement and a halt in reforms helped protecting consensus.

Despite such political stagnation, true credit and interest to deeper changes were registered in the mid-1990s when a radical pension program started to be devised and outlined. As pointed out by Hausner, it was based on the following principles, full security, protection of acquired rights, individual prudence, a multisegmented structure of the pension system, maximum freedom of choice, transparency, an active and regulatory role of the state and sustainable and balanced economic growth.

More specifically, the program would have to guarantee pensions to all age groups, that is to old-age workers, long-time employees and soon-to-be contributors, though in different ways. As for protecting acquired rights, benefits acquired prior to the new system would have to be given real value and recognition. As for individual

[84] Polakowski and Hagemejer, ” Reversing Pension Privatization: The Case of Polish Pension Reform and Re-Reforms”, 2.

prudence, the latter was set as one of the system's foundational principles: all deliberate contributions would be translated as every person's future pension, as to give greater responsibility to contributors' choices.

Furthermore, the new system would be three-pillars based: a first pillar financed on participatory basis (PAYG), a second fully funded pillar and a third voluntary though equally fully funded pillar. More specifically, the first two involved mandatory contribution whereas the third was exclusively set on a voluntary basis.

In line with the need to transform the previous unclear system in a more transparent one, a universal system of social insurance and accounts was introduced and continuously revised by the state, which would have actively regulated the functioning and operativity of all pension funds[85]. These principles formed the basis for the introduction of the relevant legislation, which was adopted in two packages by two politically different governments and parliaments.

The first package, submitted to Parliament in April 1997 by the center-left coalition, included: the Law on the Organization and Operation of Pension Fund, the Law on Employee Pension Programs and the Law on Applying the Revenues from Privatization of a Portion of State Treasury Assets for Purposes Connected with Reforming the Social Insurance System.

The second legislative package prepared and submitted to Parliament in April 1998 by the center-right coalition featured: the Law on the Social Insurance System and the Law on the new PAYG pensions from the Social Insurance Institution (ZUS)[86].

Overall, the result of the pension reform in 1999 was a shift from DB formula to a NDC formula, functioning as follows: the first pillar was set as a mandatory PAYG financed scheme based on NDC accounts, based on the newly reformed pension fund (FUS) and managed by the public agency ZUS.

The latter retained five-eighths of the mandatory pension contribution (approximately 12%). The remaining 7.3% of gross wages were to be devolved to the second fully funded pillar, based on privately managed open pension funds (OPFs). The

[85] Hausner, "Security through Diversity", 353-354.
[86] Ivi, 354-355.

latter are legally independent entities managed by licensed companies named *Powszechne Towarzystwa Emerytalne* (PTEs) and whose creation must be authorised by the Insurance and Pension Funds Supervisory Commission (KNF).

Contributors would be obliged to pay specific amounts of insurance contributions though the pension fund to which entrust one's savings would be an individual choice, no mandatory indications would be provided.

As far as the third funded voluntary pillar is concerned, the new law envisioned a variety of separate funds, as employers' pension schemes (PPEs) and pension and pension funds made of voluntary contributions (IKE/IKZEs) managed by private companies (TFIs). The amount of contribution, that is the percentage of wage, was a contracted one.

Interestingly, a zero pillar may be traced in the government's choice to guarantee a minimum pension via public funds.to those whose overall pension – from the first and second pillar – would not have reached the minimum amount.

In terms of participation, this was set as mandatory for workers born after 1969. They had to choose their preferred pension OPF (complying with the second pillar) by September 1999. Otherwise, they would have been randomly assigned to ones selected by the Pension Fund Supervisory Board. On the contrary, those born between 1949 and 1969 could choose between the old reformed PAYG system and the new system. If they opted for the latter, they would choose their desired OPF by December 1999. Finally, people over the age of fifty were not given the opportunity to choose: they were forced to stay within the old system.

Predictably, the level of participation was massive. As portrayed by Hausner "according to initial estimates, between 6 and 7 million participants were to enter the new general system (first and second pillars). The total possible number of entrants was 11.5 million, including 3.8 million born after 1968 (aged under thirty) and 7.7 million born in the years 1949– 68 (thirty-to fifty-year-olds). By the end of 1999, 10.5 million people had joined the system, each choosing one of the twenty-one registered pension funds"[87].

[87] Ivi, 356.

Summing up, a comparison of the old and new system can be carried out using multiple criteria. In terms of contributors, the old system envisioned only employers as participating to the system whereas the new prescribed an equal split of the burden among the former and employees. As far as financing is concerned, the old system consisted in a fully-fledged PAYG system whereas the new one was devised as a mixed PAYG (approx.. 12& of the salary) and funded (7%). The pension base was set on lifetime earnings rather than 10 average earnings as well as record keeping shifted from documents collected at the time of retirement contrary to the newly created ZUS individual accounts for each member. Following the establishment of individual accounts, continuously updated and managed by ZUS, each worker's first contact with ZUS coincided with starting his/her first job in order to hand in their first receipts. This greatly differed from the old system, in which the first encounter occurred when officially retiring.

Finally, the last distinctive feature of comparison refers to pension age: this was fixed at 65 for men and 60 for women in order to overcome the previous early retirement privileges, approximately 59 for men and 55 for women[88].

3.3. Recent reversing and revising of the system

The implementation of the new Polish pension system was completed in 1999 thus all subsequent government actions were driven by the willingness to solve a major concern with the financing of the relative transition costs.

As previously mentioned, Poland's overall economic condition had not reached a financial stability therefore privatization was presented as an effective means of converting an implicit pension debt to an explicit one along with the chance to guarantee long term pensions in a financially sustainable way.

Transition costs were expected to be covered from two different sources: revenues from the privatization of state-owned enterprises, reductions in the amount of benefits,

[88] Chlon-Domińczak, "Pension reform and public information in Poland", 11.

privileges of specific occupational groups and via cost-cutting measures such as the elimination of the early exit retirement option. As far as the latter is concerned, those occupational branches' representatives were able to pressure the government in delaying, modifying at abandoning reductions in their pension entitlements[89].

For this reason, designers of the reform had already indicated revenues from privatization as the main source for covering transition costs. However, actual revenues were able to do so only in the first two years leading to a consequent increase in the country's public debt. According to the data provided by the Polish Ministry of Finance and ZUS, in the period 1999-2012 costs of transfers to then privately managed second pillar were estimated to be 14.4% of 2012 GDP, to which approximately 6.8% of GDP for related public costs[90]. At the same time, privatization revenues over that same period amounted to 5.24% of 2012 GDP.

In addition, a further public burden in terms of deficit was caused by the pension fund within the first pillar, managed by ZUS. Even though part of this deficit has been attributed to the transition itself, the "ceiling on contributions introduced in the 1999 reform resulted in an additional deficit in the ZUS"[91]. For this reason, the government covered such deficit with both special subsidies and interest-free loans.

Within such framework, Poland's accession into the European Union marked the ultimate step in terms of acknowledging the rather different outcome than that expected to which the 1999 reform had led the country. According to policy, the European Commission pressured the country to meet the Maastricht criteria and subjected it to the Excessive deficit procedure (EDP), an action launched against any EU member exceeding the budgetary deficit included in the EU Stability and Growth Pact. The latter events constituted a major role in the decision to reduce the size of the privately managed pillar.

The above-mentioned elements drove late 2000s government officials to a gradual though stead reversal of the 1999 reform thus of the overall partially privatised pension system. As early as in May 2011, a new pension law (Dz.U.2011 nr. 75) addressed a partial reversal and initiated the rebuilding of a public pension system in the following

[89] Polakowski and Hagemejer, "Reversing Pension Privatization: The Case of Polish Pension Reform and Re-Reforms", xiv.
[90] Ministerstwo Finansów, *Raport Roczny 2012 Annual Report,* 8.
[91] Polakowski and Hagemejer, "Reversing Pension Privatization…", 8.

way: “contribution rate paid to the second-tier pension funds was reduced by more than half (initially to 2.3 per cent; later it rose to 2.92% in 2014) and directed to a special subaccount in the public notional DC tier; ban on pension fund marketing, to reduce high administrative costs; more aggressive investment strategy of the pension funds was allowed. – As of 2012, the retirement age was gradually raised from 60 to 67 for women (by 2040) and 65 to 67 for men (by 2020); stricter retirement rules for the military, police and similar institutions”[92].

This partial reversal was followed by a ground-breaking full reversal (prescribed in the Act Dz. Ustawa 2013 poz 1717) which established that contributions to the second pillar were made voluntary and allowed the transfer of all current accounts to the publicly managed first pillar scheme. Given the removal of the mandatory feature, participation to OPFs immediately scaled down both in terms of share and participants. Those still wishing to participate to the second pillar type funds could do so by devolving no more than 2.92% of their wages and had until July 2014 to decide. Predictably, “in early February 2014 the OFEs – another term for OPFs – found assets on their participants' accounts reduced by 51.5%. On the other hand, the Polish government found public debt burden significantly reduced; the ratio of public debt to GDP has been diminished once and for all by 9 percentage points”[93].

Finally, despite the major role played by the inability to cover the massive transition costs of the privatization process in the 2011-2013 reversal process, scholars and experts have also indicated additional factors: lower net average rates of return than those expected in the early 2000s, high administrative costs of pension funds, poor governance within ZUS, a market concentration of pension industry and low replacement rates.

[92] Ivi, xi.
[93] Ząbkowicz, “Institutional Interests and Institutional Change. Poland on the Second Wave of Pension Reforms”, 56.

Chapter IV: Case Study: Czech Republic

4.1. The pension system until 1989

The beginnings of a social insurance system in Czech Republic date back to the implementation of the Bismarckian model in the late 1880s. As mentioned in the first chapter, this envisioned the existence of separate systems according to an occupational based criteria.

In 1906 first legislation covering white collar workers, miners and civil servants was issued, followed by the 1924 regulation covering blue collar workers as well. To this stage, pensions were made up of two parts: a base part, to which employers and employees equally paid for and contributed to, and an additional individual part, financed through workers' individual contributions. Following this broadening of occupational branches covered, in 1929 a regulation based on income test was introduced followed by a mid-1940s regulation granting family benefits. Overall, retirement was set at 65 years old, for both men and women.

The country's communist takeover and its consequent gradual restructuring involved the existing social insurance system, which was nationalised and integrated in the state budget. As in other central planned economies communist-ruled the implemented pension system was that of a DB system financed on a PAYG basis. The role of the state was predominant, no individual choices were allowed. The system was based on paternalism and usage of social security for other objectives: individuals had no influence upon the decision-making process, which was managed by centrally administered state directives[94].

As far as single reforms are concerned, in 1956 new regulations on accident insurance and health insurance were issued. Parallelly, in the 1960s, ground-breaking rules on retirement age were set: in fact, the previous regulation for which age retirement of men was set to 60 and that of women to 55 was furtherly integrated in 1964 with

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[94] Král and Macha, "Transformation of old-age security in the Czech Republic ", 224.

regulation setting specific diversification for women, based on the number of children they had, ranging from 53 to 57. To this regard, new maternity benefits were introduced in 1968[95].

Overall, the social insurance system implemented by the Communists in power was marked by the suppression of all individual responsibilities. Same as salaries, which were frequently driven by political factors rather than effective productivity, pensions were featured by many discrepancies such as different treatments for different occupational groups along with different pension age retirements. Moreover, individuals could not meet their needs with the granted pensions. Frequently, the latter and personal savings were not sufficient and people were not allowed to have other forms of old-age security, such as supplementary pension insurance, leading to unbearable living conditions.

In order to grasp the above-mentioned inequalities, a World Bank 2001 study is extremely useful in comparing the lack of fair redistributive criteria: “a person who had been working for an average wage (i.e. 100% in the personal wage/average wage column) receives a pension benefit equal to 48 % of previous personal wage when retiring. A person who had been earning double the average wage receives only 27 % of personal wage after retirement. The strong redistribution and equalization of pension benefits is – most clearly visible from the third column of the table; people who had been earning 100 %, 150 % and 200 % of the average wage get from the first PAYG pillar almost the same pension benefits, which are on the level of 48 %, 51 % and 54 % of the average wage”[96].

In addition, prior to 1989 the pension system lacked any form of indexation which would have allowed a understandable flexibility and consideration of the ever-changing economic and social dynamics.

Finally, along with the absence of earnings-related formulae, major sources of disparities were pension categories defined by previous occupations, returns from loyalty and political position along with special pensions reserved to members of the communist party and communist elite.

[95]Poteraj, *Pension Systems…,* 122-123.
[96] Slavík, “The Czech pension system and the perspectives of its reform”, 216.

4.2. Developments in the 1990s

The collapse of the communist rule in Czech Republic led to a radical change in the economic system which started a massive shift towards being a market economy, rather than a centrally planned economy. As previously stated, state ownership of assets production were dismantled, distorted prices now adjusted and occupational sectors of the economy were now opened up to market forces. Parallelly, though to a minor extent, the social insurance system was taken into analysis for reform, given its reflecting of broader discrepancies that were now trying to be slowly removed.

Initial reforms were carried out in order for the pension system to comply with the new existing economic conditions. In the early 1990s, valorisation of pension benefits was enforced, leading to a reduction in the gap between wages/pensions and to a diminishment of disparities in pensions granted at different times according to different needs. In addition, as in Poland in the same years, early exit from work was still favoured: in fact, the most working pensioners were pushed out of labor force due to pressures coming from employers receiving tax incentives.

Moreover, previously unfair pension benefits covering specific groups were now positively levelled through the removal of personal pensions reserved to communist elite, communist nomenklatura, top sportsmen and artists. At the same time, the rigid distinction between occupational groups (each being granted arbitrarily chosen pensions) was removed[97].

In the midst of the macroeconomic transition towards a market-oriented economy, the Czech social policy played two different roles: a conceptual and instrumental. The latter referred to the willingness to compensate the social impact created by the economic transition. The former referred to the need to conceptually reformulate the meaning, scope and the role of social policy by greatly reducing the state's involvement[98].

[97] Večerník, "Changing social status of pensioners and the prospects of pension reform in the Czech Republic", 198-199.
[98] Král, "Transformation of old-age…", 224.

Despite not comprehensively addressing the profound income inequality featuring the country's economy, these parametric reforms are considered by Czech scholars (among others) to have "prevented retired people from of a significant loss of the real value of pension benefits, as a consequence of radical reform measures, and they adjusted the pensions to changes of the Consumer Prices Index rises plus 87% of the average real wage increases"[99].

The first structural reform was dated 1994 introducing a supplementary fully funded pension scheme that allowed citizens to contribute privately and individually. This pillar was devised as a DC system run on a fully funded basis by pension funds and/or licensed companies. Many special licensed funds were established aiming at compensating the publicly provided pension and gradually reducing the state's involvement. In addition, this fully funded pillar was also introduced "to compensate for the expected reduction in the basic pension, thus ensuring equivalence between payments and benefits, and strengthening income disparities between pensioners"[100]. The Czech government encouraged citizens to devolve maximum 500 CZK to the chosen fund, granting a public subsidy up to 120 CZK for an individual's contribution of that amount.

The subsequent systemic reform was approved in 1995 and implemented starting from January 1996, known as Pension Insurance Act. This introduced a two pillars pension system consisting of a compulsory first PAYG pillar and a voluntary funded third pillar. The former was the one inherited from the planned economy and shortly after completely reformed whereas the latter had been introduced in 1994. Additionally, the Act also raised the retirement age and greatly limited the chances to opt for an early exit from work.

As far as the second pillar was concerned, plans to introduce a mandatory fully funded pillar based on occupational schemes were being considered. Some preliminary work was done in 1999 and 2000, however all proposals were rejected being that it was considered as a possible means of endangering the already existing third pillar.

Overall, the assessment of the system's functioning up to the early 2000s is very interesting in order to grasp the ratios of the subsequent reforms. When analysing the first

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99 Slavík, "The Czech pension system ….", 216.
100 Večerník, "Changing social status of pensioners…", 200.

PAYG pillar, in its traditional social security scheme, one must point out that the latter was in surplus until 1996. Major causes were a "very low unemployment rate thus a sufficiently high number of pension system revenues and a fats growth in nominal wages in those years.

Unfortunately, the first deficit of approximately -0.5% of GDP came in 1997 and worsened in the 2000s reaching -0.9% of GDP. This shift was addressed as "linked to the cyclical development and to the process of real adjustment and restructuring of the supply side of the economy which resulted both in higher unemployment (and hence lower pension system revenues) and an increasing outflow of older employees who tried to solve their situation on the labour market by seeking early retirements (and hence higher pension system expenditure)"[101].

The steady worsening of the economic conditions inherent to the existing social insurance system led to a series of parametric reforms, implemented in 2003/2004 and concerning: "the significant decrease of non-contributory periods within higher education considered as a period of participation in the pension system, the elimination of earlier retirement with only temporary decrease in benefits, the increase in the contribution calculation base for self-employed people from 35% of the net remuneration to 50%, the gradual increase in the retirement age to the level of 63 years for both sexes, the increase in pension contribution amount from 26% to 28%"[102].

As of the end of the 2000s one may trace the main patterns of both the obligatory and voluntary pillars. As far as the first is concerned, the retirement age is 61 for men and 56-60 for women. These may not be complied with, anticipating retirement up to three years earlier if one had paid 25 years of contributions thus agreeing to a permanent reduction of 0.9% of his/her pension. On the contrary, one may receive his/her full pension and relative benefits after 15 contributory years as long as these are requested after the age of 65 years. Predictably, postponing retirement is awarded with an increase in the pension base benefit by 6% year.

Structure of pensions, those deriving from one's mandatory contributions to the first pillar, includes two elements: "the fixed part, determined by the rules of law and the

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[101] Slavík, "The Czech pension system ….", 217.
[102] Poteraj, History of pensions…, 124-125.

variable part, dependent on the amount of the paid contributions"[103]. Naturally, the fixed part is the same for all pensioners, no matter the time of contribution and value of income whereas the variable part "for each contributory year a pensioner receives 1.5% of the individual calculation base"[104].

As far as the voluntary system is concerned, the number of participants is 2.5 million people however the average contribution to the system is only 2% of one's salary. Each individual may participate to one chosen fund with a minimum contribution of 100CZK, to which a government subsidy is linked in the amount of 50 to 150 CZK. In order for one to participate to the system he/she must have turned 18 and is either a permanent resident of the Czech Republic or lives in a different Member state of the European union. Despite the relatively high number of citizens participants, the rather low amount might be caused by the low rate of return on investments reached by these funds[105].

4.3. Attempts to introduce a second pillar

The assessment of additional major reforms leads to pointing out the comprehensive pension reform launched in 2013 aiming introducing a mandatory fully funded pillar, thus what is known as the second pillar. This had been postponed in the previous years and waves of reform for the reasons that have been discussed above.

Overall, this comprehensive reform was based on four elements: "an increase in the retirement age based on the increasing survival age, the establishment of a second pillar opt-out retirement savings product, the transformation and closure of the old third pillar supplementary pension insurance system and the establishment of a new third pillar solution under the new supplementary pension savings product"[106].

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[103] Ivi, 127.
[104] Ibid.
[105] Ivi, 128.
[106] Šindelář and Erben, "Does an attractive pension product design sell by itself? The experience of Czech Republic", 35.

In fact, the earlier fear of reducing the coverage and importance of the functioning third pillar had been overcome thanks to a new devise of the pillar itself. The latter was integrated with new supplementary pension savings and substitute products such as investment funds and life insurances. Interestingly, comparative political analysts have considered that despite the attractiveness of the pension products' design these have been hampered by the unattractiveness of their distribution features.

According to the committee associated with the government at that time, the goal of the reform were fourfold: "greater diversification, fiscal sustainability, fairer distribution of the intergenerational burden over time and a certain increase in equivalence"[107].

At the end of 2013 over 5.1 million unique contracts were registered within the newly reformed third pillar for a total population of 10.5 million inhabitants. Despite the massive prevalence among the Czech population, very little public discourse and criticism was devoted to the reform's part concerning the former.

On the contrary, the core part of the reform, that is the implementation of a second mandatory fully funded pillar, soon started attracting fierce opposition and criticism both within the political arena and academia thus leading to its deposition by the new government in 2016.

[107] Ibid.

CONCLUSIONS

The present thesis has traced the history and gradual development of multiple transformations within pension systems, both in Western and Eastern Europe, leading me to a quite surprising assessment in terms of similarities among these two paths. Both originate and initially flourish within the common Bismarckian model, implementing occupational based systems to whose members and workers were granted fixed benefits. In terms of financing, PAYG systems were quite predominant until the late 1980s and early 1990s: current workers would contribute for current pensioners.

What has been referred to as Defined-Benefit systems based on a PAYG basis feature both Eastern and Western Europe until the early 1940s. In fact, until that moment, several points of convergence have been identified both in terms of driving forces and in the scope chosen as to how devise pension systems.

As far as the driving forces are concerned, one has pointed out the need to politicise the issue of an ageing population expecting to be granted an indexed pension, whose conceptualisation radically changes: pensions are no longer associated to disability allowances rather to the government's duty to provide for its elder citizens. In addition, the role of political parties and the increasingly popular socialist parties have been given importance in the process of reasoning.

As far as the scope is concerned, the involved sectors are the same: civil servants, white-collar workers and blue-collar workers. Similarities featured the means of social insurance systems as well, given that contributions were indeed mandatory though earnings-related.

Such described convergent path is halted in the aftermath of World War II. In fact, despite both sharing the war's well-known dramatic consequences, Eastern Europe's political and/or territorial occupation at the hands of the Soviets inevitably drives it away from the evolution visible in Western Europe.

Even though the installation of Soviet-based central planned economies has not been overall discussed, its consequences with regard to the social insurance system have been identified in multiple trends.

First of all, pensionary expenses were integrated in the state budget, leading to no financial autonomy for the pensionary system and to losing the perception of pensioners' effective needs, as contributions remained more or less the same for decades as neither deficits nor surpluses were calculated. Therefore, an overall levelling of elderlies' conditions, increasingly poor and marginalised, has been registered especially with reference to a lack of pension indexation, which was introduced in the early 1980s.

Parallelly, a number of inequalities among pensioners in terms of granted benefits were institutionalised: in fact, personal pensions were given to members of the communist elite and nomenklatura along with members of economically strategic sectors, as miners and heavy industry workers. Furthermore, contrarily to what was implemented in Western Europe in the form of an early exit from work option, Eastern European governments endorsed an additional lowering of the age retirement leading to massive deficient state budgets.

All the above contribute to a rising collective intolerance and unsatisfaction with respect to the state's role. Such continuous interference is extremely evident in pension systems as well and resulted in selecting a diametrically opposed path once USSR had collapsed.

In fact, the impressive shift of approximately twenty Eastern European countries towards either full or partial privatization of their pension systems has been inserted in a broader scenario, which does not solely include economic factors rather social and political ones too. To this regard, the case of Poland is strikingly fascinating: the 1999 pension reform implementing a second fully funded mandatory pillar represents one of the most important examples of reversal of decades long trend.

Following nearly fifty years of centrally planned economy, the early 1990s governments opted for a dual transition: one towards a market economy-oriented economy and another towards a multipillar system. The obligatory nature given to the second funded pillar is notable, especially when considering the opposite path undergone by the alternative case study presented, Czech Republic, whose history and choices are profoundly different.

Finally, Poland's recent reversal, mainly caused by the debt-based nature of the transitions, which were expected to be balanced by privatization revenues, must not cover its extraordinary ductility and versatility demonstrated in such a small amount of years and lacked by Czech Republic who did implement a mandatory fully funded pillar in 2013 though promptly removing it in 2016.

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CHAPTER I

Two distinct pensionary models have been considered as foundational examples from most European countries: the Bismarckian Model and the Beveridgean Model. The Bismarckian system dates back to 1889, year in which German Chancellor Otto von Bismarck introduced a contributory old-age pension system for industrial and lower paid white-collar workers, making Germany the first country in the world to introduce a compulsory national old-age pension scheme. This aimed at covering as much as half of the working population. The novelty of this model concerned its obligatory nature: all employers had to comply with it and were to be held responsible for not doing so. Contributions were paid in 50% by employees and in 50% by employers, assisted by the central budget. The employers' contributions were then collected and transferred to an insurance institution which was obliged by law to invest them and regularly pay pensions.

Parallelly, the Beveridgean model is named after William Henry Beveridge, who in the late 1940s was asked to provide an unbiased assessment of the then exiting British social insurance system and proposed charging each working person a fixed weekly contribution for pensions to be paid on a weekly basis as well, granted to whoever reached the age required by law. Beveridge's proposals lied the foundation of Britain's post-war social insurance system, envisioning benefits for the entire population, financed by the state's budget rather than solely from payroll taxes and calling for uniform lumpsum contributions.

Pension systems' expansion occurred after World War II, definitely overcoming the previous asset of modest coverage and limited extensiveness of benefits: the elderly, in the aftermath of World War II, started being recognised as individuals worthy of assistance and of protection. In addition, Several European countries, that had been granting benefits to specific occupational sectors, extended their coverage to the entire working population. The gradual increase in supporting trade unions required increasingly important social insurance reforms and benefits as the extension of coverage to previously uninsured workers determined a massive increase in the pension expenditure. The enlargement of coverage followed different paths and by the early 1950s, two different systems had emerged, social insurance and multipillar, whose main differences concern how benefits were distributed and how pension systems were financed.

Predictably, social insurance systems are of Bismarckian inspiration, granting earnings related benefits to former workers on a contributory basis , meaning that benefits depend on the contributions made while working. This system is financed on a pay-as-you-go basis (PAYG): current pensions are financed by current contributions. Moreover, they generally envision a means-tested minimum pension. For this reason, the state is extremely central in providing its population with a generous pension thus significantly preventing the development of private pension provision.

On the other hand, multipillar pension systems provide a flat-rate minimum benefit on the state's part, considered as sufficient to cover basic needs. This system's goal is to prevent widespread poverty among the elderly. The state's role is extremely limited, leaving plenty of space to the private sector which becomes gradually embedded in the pension system, either in a compulsory or quasi compulsory form. Multipillar systems usually may be funded combining two different ways: the publicly provided one through a PAYG basis, same as the social insurance type whereas their private component is generally fully funded, that is current contributions are used to finance future benefits.

The late 1940s shift towards overall expansionary policies lasted throughout the 1950s, 1960s and early 1970s, as these were decades of prosperous economic growth in Western European countries. The impact of such costly policies was less of an issue, as governments allocated high budgetary expenditures to pension in societies whose age structure was that of a young and growing population, with an extremely low number of elderly.

During the mid-1970s and early 1980s, Western European scenarios profoundly changed: structural constraints as demographic challenges and slow economic growth impacted the overall performance. Epochal social transformations as the emergence of the post-industrial labor market and its consequent new demands along with an ever-changing family structure, inevitably led to new social needs, which promptly changed governments' agendas. Low levels of growth rise in unemployment and demographically caused rises in social expenditures gave a lethal shock to quasi mature social insurance systems.

The most widespread social practice against such events was the massive use of early retirement provisions and schemes. These aimed at reducing the then existing job supply of labor thus lowering unemployment, specifically youth one. This path was included in the broader endorsement on governments' part of passive labor market policies.

However, in light of the excessive financial cost of such policy, Western European countries experienced significant financial pressures. For this reason, starting from the early 1980s most of them opted for a gradual paradigm shift away from passive labor market policies by reversing the previously implement early retirement scheme. Such abandonment was pursued in many different ways: by raising the retirement age, reforming disability insurance, closing special early retirement programs, activating older workers and fostering gradual transitions towards retirement.

The focus of policymakers was towards cost containment and retrenchment of benefits. Trends of reform included tightening requirements needed for one to receive a full pension, non-contributory years were eliminated and lower pensions were granted to those with a less full employment record, increasing the age of retirement and consolidating a binding age retirement. As far as financing was concerned, initial stages of a transition towards implementing a defined contribution system were pursued. In addition, for the first time ever, unpaid family work was included into the benefit calculation: childcare assistance activities and frail elderlies' assistance were both in higher benefits' calculations.

Finally, the paradigmatic shift registered in the late 1990s and early 2000s in many Western European countries may be summarised in the overall attempt to move towards the privatization and marketization of pension systems, implementing a multipillar pension architecture and more space being given to either prefunded or funded elements. Within this ground-breaking shift was largely influenced by the 1994 World Bank report *Averting the Old-Age Crisis: Policies to protect the old and promote growth.* In fact, it was the first time in which the concept of dividing pension schemes into pillars was proposed.

In general terms, a first mandatory publicly managed pillar was introduced, in line with the World Bank's continuous emphasis on the need to protect the elderly against absolute poverty. This should be reached via a flat pension for everyone rather than via means tested benefits. This was followed by a privately though mandatory or quasi-mandatory supplemented plan, as second pillar, whereas the third pillar was set as a prefunded private voluntary supplementary plan, available to those who would be willing to supplement even more the benefits provided by the first two pillars.

CHAPTER II

Eastern European countries established different forms of the Bismarckian-style pension, linking benefits to a specific professional status. Overall, these countries' systems consisted of a continuation of Bismarck's previously introduced pattern, predicting the existence of separate systems for different professional categories.

At the beginning of the 20th century, in the years 1906-1933, pension schemes were based on a corporatist vision of social solidarity aiming to secure occupational standards along with reproducing professional achievements. The management of the social security system was decentralised and its main financing mechanism was via social insurance contributions covering individuals against risks associated with old age and health. The first significant developments occurred after the end of World War I: health, accident and pension insurance regulations were implemented in many Eastern European countries.

Massive changes were implemented after the Soviet occupation in the aftermath of World War II. The main characteristics of the Soviet Social security system were: a generalisation of the schemes, a broadening of the coverage to include the whole working population, a financial merging of the state and the social security budget, no unemployment insurance and a separation of national health services. The main socialist social policy instruments were full employment and price subsidies for goods and services. Financial autonomy was abandoned by including social expenditures in the state budget. Contributions were mandatory, paid almost exclusively by enterprises, employers and administrations and were calculated on the basis of employees' gross income.

Special attention deserves the extremely low retirement ages in place throughout Eastern Europe: as previously mentioned, prior to the collapse of USSR, the normal retirement age was 60 for men and 55 for women. However, an even lower age was set for special occupations, such as heavy industry workers or miners, for which full pension was granted at the age of 45 for women and 55 for men. In order to grasp the huge financial impact that such low retirement ages had on the states' budgets, the case of Poland serves as optimal example. In fact, in 1990 40% of all age pensioners were below the standard retirement age, considered to be about 57 for men and 53 for women. Being that at age 60, women were estimated to have a life expectancy of over 19 years whereas men to have one of 16 years, this led to a post-retirement life of over 25 years, predictably unbearable from a fiscal perspective.

The subsequent cornerstone historical moment coincided with the collapse of USSR and its relative transition. One of its main features was a crisis in pension systems due to the rapidly changing demographic transition and the dependency burden weighing on the working population. Such high and ever-growing expenditures in pensions undermined both the stabilization of the newly founded independent countries and the principles according to which other government expenditures could have been administered. Pensions underwent three main reform phases, up to the ultimate embracement of the World Bank's contested "New Pension Orthodoxy".

This multi-phase decade long pattern has been identified as featuring three different types of changes, driven by distinctive matrices: changes triggered by economic transformation, a period characterised by changes representing changing social objectives but at the same time hampered by political/economic/institutional barriers and a period in which comprehensive reforms with long-term changing distributional objectives were accomplished.

The first changes were implemented between the year 1989 and 1992/1993 and included the introduction of indexation, the implementation of a new form of coverage for self-employed people and the formal abolition of politically motivated privileges. The second phase of reform is assessed as having taken place between 1992/1993 and 1995/1996, during which there were many small changes aiming at fulfilling new goals in new directions. Four main developments are considered to have characterised this period: changes in the benefit formulas, changes in the organisational structure of the pension systems, a growing financial independence and the introduction of a voluntary pension insurance. The third phase of the transformation of the pension system, temporally placeable starting from 1995 onwards, was profoundly affected by the 1994 World Bank principles, which gave birth to the multi-pillar system. This was a phase of comprehensive reforms, no longer implemented within the institutional framework prior to 1989. In fact, it was characterised by different political decisions, predictably leading to different outcomes based on each Eastern European country's national context, though sharing a common implementation of a mandatory second pillar.

The late 1990s and early 2000s registered a gradual though steady shift of Eastern Europe towards pension privatization, reflecting the global trend towards the introduction of privately funded pension funds. The concentration of pension privatization among post-communist countries was surely not coincidental: the latter were within a profoundly negative financial context, featuring massive public deficits following decades-long if not centuries-long implementations of costly policies therefore the completely state-run pension system had become unsustainable.

The implementation of an effective privatization was considered as the ideal solution to address the then-current fiscal imbalances and growing demographic ageing, boost economic growth and easily stimulate greater economic growth. Approximately fourteen countries started replacing their publicly managed pension accounts with mandatory private retirement ones. The model adopted was a a combination of public pay as you go (PAYG) pillar that is sometimes means-tested and a second pillar of mandatory individual accounts.

In order for the privatization wave to quickly take place, the role of the World Bank and other International Financial Organizations was fundamental through the creation of a high-profile network of international officials capable of promoting and advising involved countries' officials in the reform's successful and effective implementation.

Many reforming countries either slowly or more rapidly, opted for major mandatory contributions within the second pillar. The latter trend suddenly halted in 2008 concurrently with the global financial and economic crisis which triggered major destabilization in the economies of Eastern European countries. In fact, several reforming countries decided to decrease the coverage and extent of pension contributions channelled to the second pillar, giving birth to a second trend, defined as the pension privatization reversal. The underlying reasons of reform reversal are multiple and highly debated, given that scholars have not agreed on the predominantly aggravating cause which led to the reversal trend. In fact, current literature emphasis different aspects and pressures exerted by several distinct institutions.

Most of the explanations concerning reform reversal stress the highly challenging pressure following the 2008 global financial crisis. Parallelly, scholars have also indicated the asymmetrical treatment among impression pension debt and explicit public debt in the EU Stability and Growth Pac. EU fiscal regulations are considered to have penalized in the terms of not having stressed the importance of implementing austerity measures to these carve out pension privatization trends in the first place.

Reform reversal, as earlier described for the privatization trend, has been extremely diversified across countries thus it is very hard to delineate a single process of reversal. Given these differences in carrying out privatization reversal, its consequences are naturally different and varying on a single nation basis. Existing literature reflects the debated consequences of reform reversal: on one hand, some suggest that reform reversal will constitute a burden for future generations, heavily impacting the chances for future young generations to carry out a sustainable economic and financial growth and personal enrichment; on the other hand, others point out that reversal could actually improve pension system in an efficient way especially in Eastern European countries, which carried out a debt financed transition towards pension privatization.

CHAPTER III

The beginnings of the Polish pension system date back to the second half of the 19^{th} century though differing based on the legal regulations of each then-occupying country. The Austrian, Prussian and Russian legislations and regulations applied to their respective occupied polish territories. Such a differentiated and fragmented system was overcome in 1927 and culminated in the establishment of a Social Security Institution (*Zakład Ubezpieczeń Społecznych*, ZUS) in 1934.

Starting from the early 1940s, the Polish social security system experienced a proliferation of Acts and amendments, frequently circumscribed to single categories (such as farmers, miners, state employees etc) contributing to the creation of severe instability and uncertainty. To this extent, the 1940s themselves saw three major transformations: in 1944 new Acts on social insurance were issued mainly abolishing most provisions included in the previous ones. However, the ZUS was preserved as well as both the blue collar and white-collar workers pension funds.

Similarly disruptive, in 1945 an Act was passed which changed the method for collecting contributions: the latter were no longer shared by employers and employees being that employers were now being obliged to pay all contributions in full. Soon after, in 1949, another transforming Act was passed which changed once again the method and management of contributions' collection: there would be a single institution (ZUS) to manage a fund, which would collect all the contributions from health, accident, and pension insurance.

Predictably, as the Soviet penetration became increasingly heavy, previously existing polish republican systems and procedures were abolished: the ZUS was incorporated in the state budget and put under direct supervision of the Ministry for Labour. The eradication of the polish security system continued with a further 1950 decree that, among other provisions, established the abolishment of the ZUS and changed all existing regulations on old-age income security: all pensions and provisions became under the authority of the Minister for Labour and Social Security. Soon after, in 1960, the ZUS was re-founded and the Ministry for Labor and Security was no longer in charge of matters related to pensions.

Furthermore, one must also highlight the strikingly important reform advanced in 1977 and later implemented in the early 1980s, according to which the rural population was finally covered by the system. In fact, a separate agricultural fund was set in order for farmers to gradually make up their proper capital. Equally important, in 1986 the indexation of pensions was introduced and the ZUS was separated from the state budget, anticipating major changes that would have occurred starting from the early 1990s, following the collapse of USSR. Among many, an increase in the number of people collecting a pension payments, the fall in the number of contributions due to an increasingly higher unemployment rate and a significant increase in the real value of pensions in relation to remuneration, which had reached a level of approximately 38% in 1986.

According to scholars, the overall functioning of the Polish social security system until 1989 was majorly negative. It has been addressed as financially insolvent due to many factors: some common to all modern societies in the second half of the 20th century, some shared by other communist-led countries and others intrinsically linked to Poland's societal features. As far as the first set of factors is concerned, the birth rate fall and a rise in average life expectancy slowly though steadily pressured the system.

As far as the second set is concerned, communist led-countries usually feature great pressures on specific occupational branches, which are highly benefited: miners and workers in the heavy industry were the ones to gain excessive influence in Poland. As far as the third set is concerned, massive loss of Polish human lives during World War II and the fierce rebellion to Soviet occupation, greatly contributed to an even more slow demographic recovery.

For these reasons, several parametric changes were introduced in the early 1990s: lengthening the reference period used for calculating pension benefits from 12 months to 10 years, a reduction of the so-called non-contributory periods that could be considered when calculating the pension to the maximum of one-third of the total insurance history, among others.

Nevertheless, awareness on the need to reform the social insurance system had been growing since the beginning of the macroeconomic transition: politicians and experts largely shared the need to partly overcome the then-existing PAYG system and to introduce a funded insurance component, in line with the global shift towards pension privatization. However, the then existing stagnation was also politically driven: in times in which high unemployment and great economic difficulties were widespread across Polish population, early retirement and a halt in reforms helped protecting consensus.

Despite such political stagnation, true credit and interest to deeper changes were registered in the mid-1990s when a radical pension program started to be devised and outlined. As pointed out by Hausner, it was based on the following principles, full security, protection of acquired rights, individual prudence, a multisegmented structure of the pension system, maximum freedom of choice, transparency, an active and regulatory role of the state and sustainable and balanced economic growth.

More specifically, the program would have to guarantee pensions to all age groups, that is to old-age workers, long-time employees and soon-to-be contributors, though in different ways. As for protecting acquired rights, benefits acquired prior to the new system would have to be given real value and recognition. Furthermore, the new system would be three-pillars based: a first pillar financed on participatory basis (PAYG), a second fully funded pillar and a third voluntary though equally fully funded pillar. More specifically, the first two involved mandatory contribution whereas the third was exclusively set on a voluntary basis.

The above resulted in the 1999 pension reform featuring a shift from DB formula to a NDC formula and functioning as follows: the first pillar was set as a mandatory PAYG financed scheme based on NDC accounts, based on the newly reformed pension fund (FUS) and managed by the public agency ZUS. The latter retained five-eighths of the mandatory pension contribution (approximately 12%). The remaining 7.3% of gross wages were to be devolved to the second fully funded pillar, based on privately managed open pension funds (OPFs). The latter are legally independent entities managed by licensed companies named *Powszechne Towarzystwa Emerytalne* (PTEs) and whose creation must be authorised by the Insurance and Pension Funds Supervisory Commission (KNF). Contributors would be obliged to pay specific amounts of insurance contributions though the pension fund to which entrust one's savings would be an individual choice, no mandatory indications would be provided.

As far as the third funded voluntary pillar is concerned, the new law envisioned a variety of separate funds, as employers' pension schemes (PPEs) and pension and pension funds made of voluntary contributions (IKE/IKZEs) managed by private companies (TFIs). The amount of contribution, that is the percentage of wage, was a contracted one. Interestingly, a zero pillar may be traced in the government's choice to guarantee a minimum pension via public funds.to those whose overall pension – from the first and second pillar – would not have reached the minimum amount.

Summing up, a comparison of the old and new system can be carried out using multiple criteria. In terms of contributors, the old system envisioned only employers as participating to the system whereas the new prescribed an equal split of the burden among the former and employees. As far as financing is concerned, the old system consisted in a fully-fledged PAYG system whereas the new one was devised as a mixed PAYG (approx.. 12& of the salary) and funded (7%). The pension base was set on lifetime earnings rather than 10 average earnings as well as record keeping shifted from documents collected at the time of retirement contrary to the newly created ZUS individual accounts for each member. Following the establishment of individual accounts, continuously updated and managed by ZUS, each worker's first contact with ZUS coincided with starting his/her first job in order to hand in their first receipts. This greatly differed from the old system, in which the first encounter occurred when officially retiring.

Transition costs were expected to be covered from two different sources: revenues from the privatization of state-owned enterprises, reductions in the amount of benefits, privileges of specific occupational groups and via cost-cutting measures such as the elimination of the early exit retirement option. As far as the first one is concerned, actual revenues were able to do so only in the first two years leading to a consequent increase in the country's public debt. According to the data provided by the Polish Ministry of Finance and ZUS, in the period 1999-2012 costs of transfers to then privately managed second pillar were estimated to be 14.4% of 2012 GDP, to which approximately 6.8% of GDP for related public costs[108]. At the same time, privatization revenues over that same period amounted to 5.24% of 2012 GDP.

Within such framework, Poland's accession into the European Union marked the ultimate step in terms of acknowledging the rather different outcome. According to policy, the European Commission pressured the country to meet the Maastricht criteria and subjected it to the Excessive deficit procedure (EDP) which constituted a major role in the decision to reduce the size of the privately managed pillar.

The above-mentioned elements drove late 2000s government officials to a gradual though stead reversal of the 1999 reform thus of the overall partially privatised pension system. As early as in May 2011, a new pension law addressed a partial reversal and initiated the rebuilding of a public pension system. This was followed by a ground-breaking full reversal establishing that contributions to the second pillar were made voluntary and allowed the transfer of all current accounts to the publicly managed first

[108] Ministerstwo Finansów, *Raport Roczny 2012 Annual Report,* 8.

pillar scheme. Given the removal of the mandatory feature, participation to OPFs immediately scaled down both in terms of share and participants.

Finally, despite the major role played by the inability to cover the massive transition costs of the privatization process in the 2011-2013 reversal process, scholars and experts have also indicated additional factors: lower net average rates of return than those expected in the early 2000s, high administrative costs of pension funds, poor governance within ZUS, a market concentration of pension industry and low replacement rates.

CHAPTER IV

The beginnings of a social insurance system in Czech Republic date back to the implementation of the Bismarckian model in the late 1880s envisioning separate systems according to an occupational based criteria. In the early 1900s pensions were made up of two parts: a base part, to which employers and employees equally paid for and contributed to, and an additional individual part, financed through workers' individual contributions.

The country's communist takeover and its consequent gradual restructuring involved the existing social insurance system, which was nationalised and integrated in the state budget. As in other central planned economies communist-ruled the implemented pension system was that of a DB system financed on a PAYG basis. The role of the state was predominant, no individual choices were allowed. The system was based on paternalism and usage of social security for other objectives: individuals had no influence upon the decision-making process, which was managed by centrally administered state directives.

Overall, the social insurance system implemented by the Communists in power was marked by the suppression of all individual responsibilities: pensions were featured by many discrepancies such as different treatments for different occupational groups along with different pension age retirements. Moreover, individuals could not meet their needs with the granted pensions. Frequently, the latter and personal savings were not sufficient and people were not allowed to have other forms of old-age security, such as supplementary pension insurance, leading to unbearable living conditions.

In addition, prior to 1989 the pension system lacked any form of indexation which would have allowed a understandable flexibility and consideration of the ever-changing economic and social dynamics. Furthermore, along with the absence of earnings-related formulae, major sources of disparities were pension categories defined by previous occupations, returns from loyalty and political position along with special pensions reserved to members of the communist party and communist elite.

The collapse of the communist rule in Czech Republic led to a radical change in the economic system which started a massive shift towards being a market economy, rather than a centrally planned economy. Initial reforms were carried out in order for the pension system to comply with the new existing economic conditions. In the early 1990s, valorisation of pension benefits was enforced, leading to a reduction in the gap between wages/pensions and to a diminishment of disparities in pensions granted at different times according to different needs. In addition, as in Poland in the same years, early exit from work was still favoured: in fact, the most working pensioners were pushed out of labor force due to pressures coming from employers receiving tax incentives.

Moreover, previously unfair pension benefits covering specific groups were now positively levelled through the removal of personal pensions reserved to communist elite, communist nomenklatura, top sportsmen and artists. In the midst of the macroeconomic transition towards a market-oriented economy, the Czech social policy played two different roles: a conceptual and instrumental. The latter referred to the willingness to compensate the social impact created by the economic transition. The former referred to the need to conceptually reformulate the meaning, scope and the role of social policy by greatly reducing the state's involvement. Despite not comprehensively addressing the profound income inequality featuring the country's economy, these parametric reforms are considered by Czech scholars to have prevented retired people from of a significant loss of the real value of pension benefits.

The first structural reform is dated 1994 introducing a supplementary fully funded pension scheme that allowed citizens to contribute privately and individually. This pillar was devised as a DC system run on a fully funded basis by pension funds and/or licensed companies. Many special licensed funds were established aiming at compensating the publicly provided pension and gradually reducing the state's involvement.

The subsequent systemic reform was approved in 1995 and implemented starting from January 1996, known as Pension Insurance Act. This introduced a two pillars pension system consisting of a compulsory first PAYG pillar and a voluntary funded third pillar. The former was the one inherited from the planned economy and shortly after completely reformed whereas the latter had been introduced in 1994. As far as the second pillar was concerned, plans to introduce a mandatory fully funded pillar based on occupational schemes were being considered. Some preliminary work was done in 1999 and 2000, however all proposals were rejected being that it was considered as a possible means of endangering the already existing third pillar.

When analysing the first PAYG pillar, in its traditional social security scheme, one must point out that the latter was in surplus until 1996. Unfortunately, the first deficit of approximately -0.5% of GDP came in 1997 and worsened in the 2000s reaching -0.9% of GDP due to higher unemployment rates and an increasing outflow of older employees who tried to solve their situation on the labour market by seeking early retirements.

As of the end of the 2000s one may trace the main patterns of both the obligatory and voluntary pillars. As far as the first is concerned, the retirement age is 61 for men and 56-60 for women. These may not be complied with, anticipating retirement up to three years earlier if one had paid 25 years of contributions thus agreeing to a permanent reduction of 0.9% of his/her pension. On the contrary, one may receive his/her full pension and relative benefits after 15 contributory years as long as these are requested after the age of 65 years.

Predictably, postponing retirement is awarded with an increase in the pension base benefit by 6% year. Structure of pensions, those deriving from one's mandatory contributions to the first pillar, includes two elements: a fixed part determined by the rules of law and a variable part dependant on the amount of paid contributions. As far as the voluntary system is concerned, the number of participants is 2.5 million people however the average contribution to the system is only 2% of one's salary. Each individual may participate to one chosen fund with a minimum contribution of 100CZK, to which a government subsidy is linked in the amount of 50 to 150 CZK.

Finally, it appears interesting to point out the 2013 comprehensive reform aiming introducing a mandatory fully funded pillar and at reducing the coverage and importance of the functioning third pillar. At the end of 2013 over 5.1 million unique contracts were registered within the newly reformed third pillar for a total population of 10.5 million inhabitants though attracting little public discourse and criticism. On the contrary, the core part of the reform, that is the implementation of a second mandatory fully funded pillar, soon started attracting fierce opposition and criticism both within the political arena and academia thus leading to its deposition by the new government in 2016.