

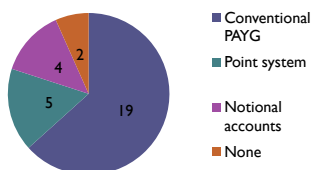
## Pension Reforms Revisited

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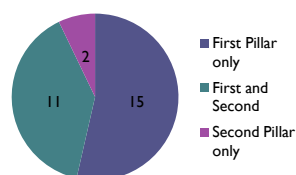
### All Countries in the Europe and Central Asia Region Have Undertaken Reforms

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

Types of PAYG systems in ECA region



Pillar Configuration of ECA Pension Systems

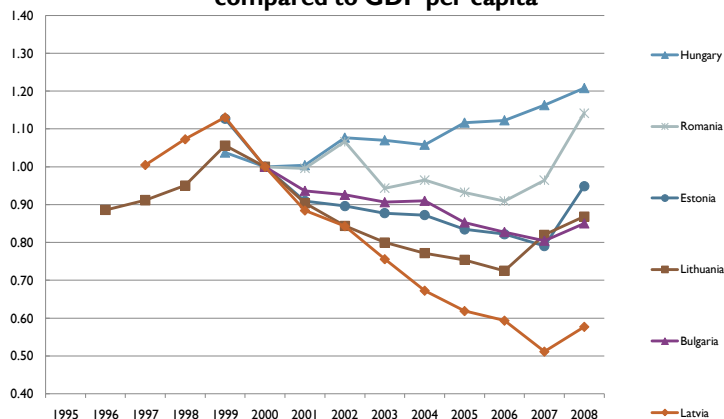


## First Pillar Reform Experience – Retirement Ages:

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

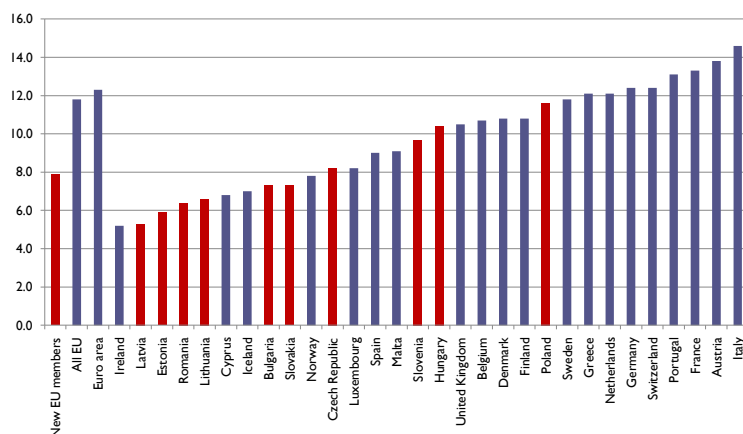
## First Pillar Reform Experience – Pension Spending:

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



## EU Pension Spending (% of GDP)

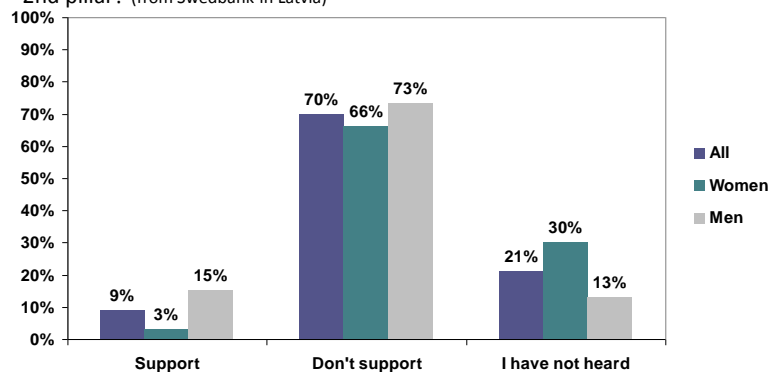
EuroStat, 2007



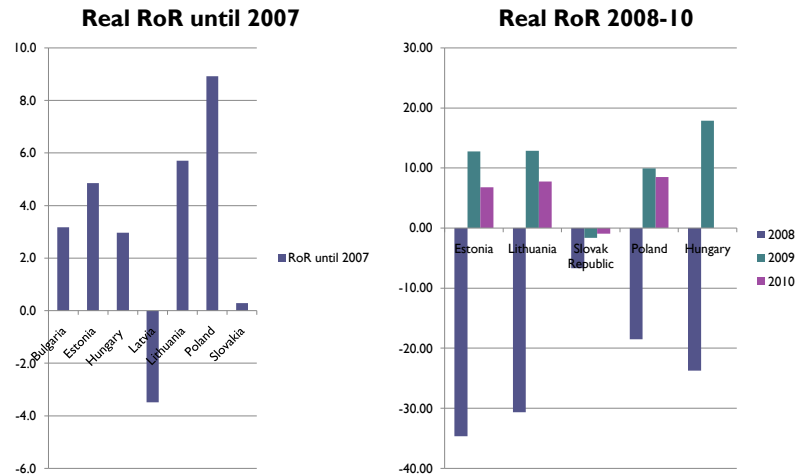
- New EU members spend less (8% versus 12%). OECD spends 7.2%.
- New EU members have fewer over 65 year olds, lower contributor base

## Second Pillar Reform Experience: People Like the Individual Accounts

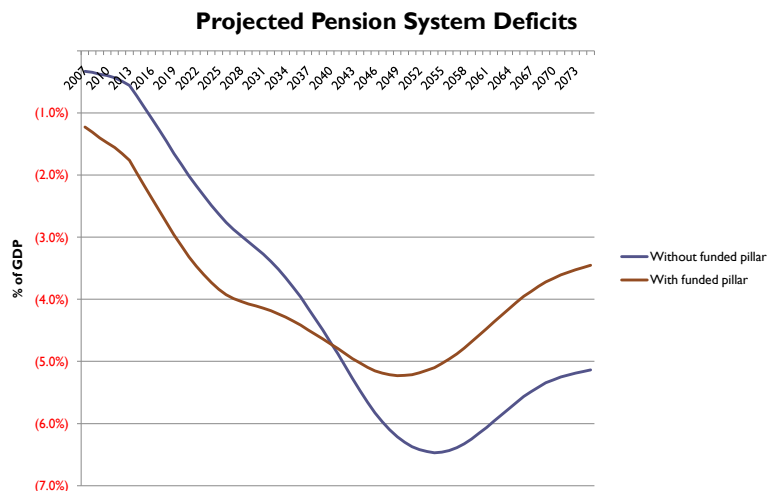
What is the public opinion with respect to reduction in contribution to 2nd pillar? (from Swedbank in Latvia)



## Rates of Return Have Been Reasonable



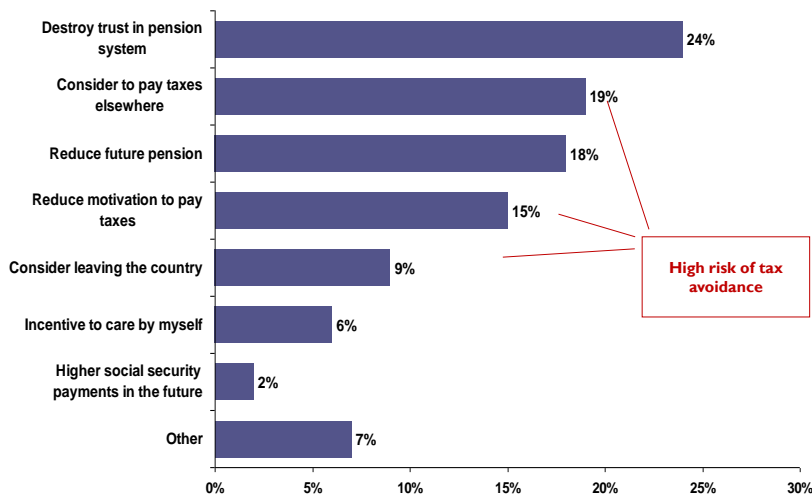
## Funded Pillars Allow to Pre-pay Future Obligations of Public System



## Financial Crisis Has Led to Some Reform Reversals

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

## What Would be the Consequences of 2<sup>nd</sup> pillar Contribution Reduction? (Swedbank, Latvia)



## Unexpected Outcomes from Second Pillars

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

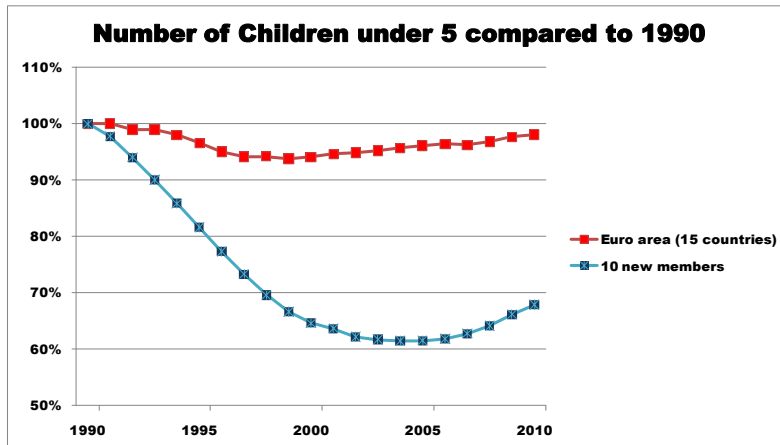
## What are these Reforms and Reversals Trying to Achieve?

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

## New Realities for Central Europe

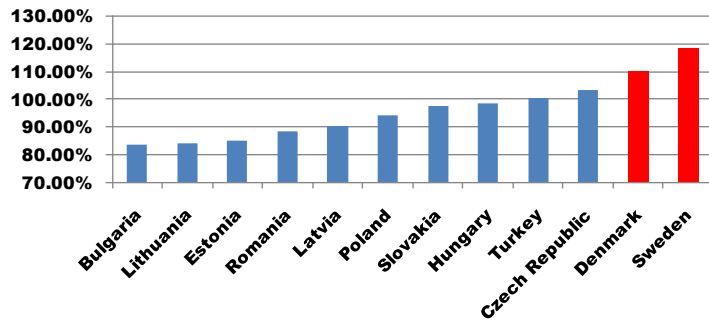
- EU accession and increased market integration
- Tighter enforcement of the Stability and Growth Pact
- New fiscal challenges arising from slower growth following the financial crisis
- Disillusion with “miracle” cures in pension systems
- Starker demographics
  - Sharper decline in fertility
  - Prolonged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

## Fertility Rates Have Dropped by a Third Between 1990 and 2010

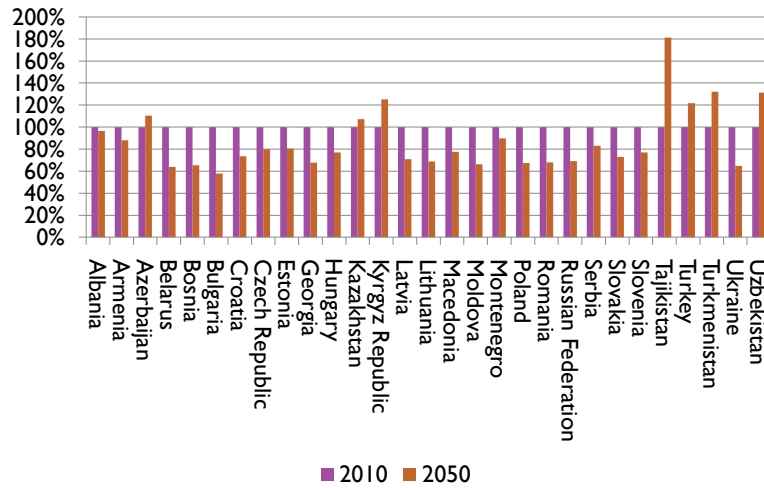


## Working Age Population is Shrinking Due to Emigration

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



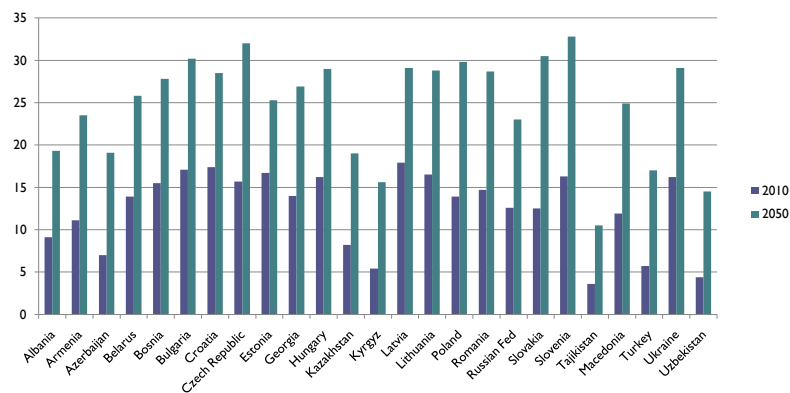
## Resulting Decline In Working Age Population



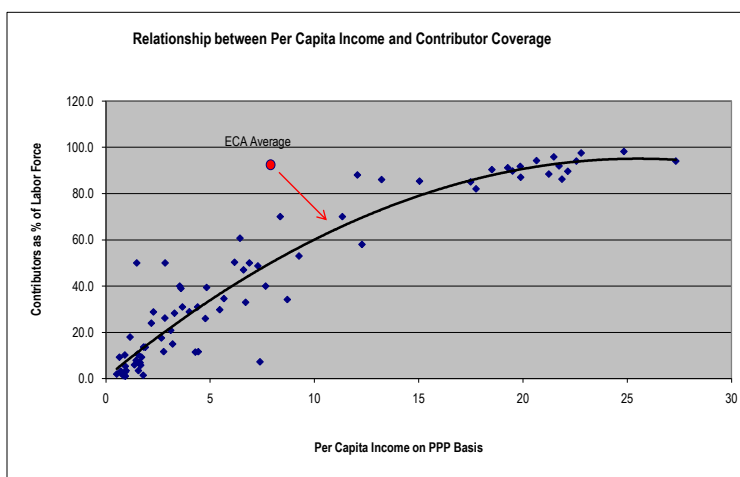


## Aging of the Population

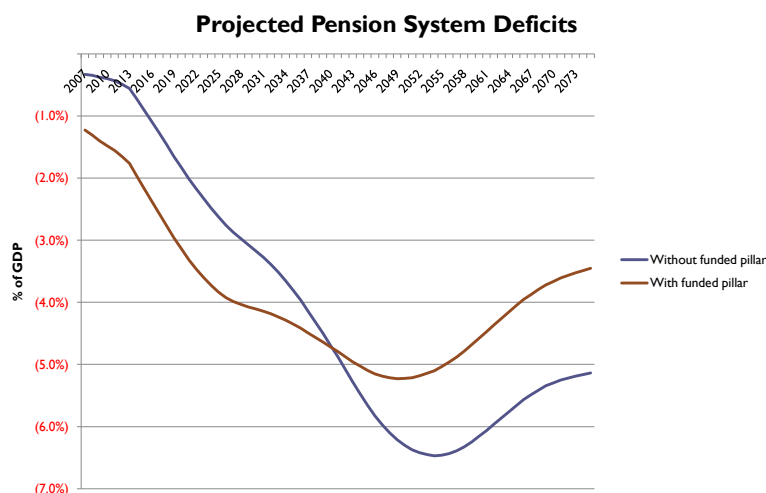
- Percentage of the population over 65



## Central Europe Had Unusually High Coverage Rates Prior to Transition



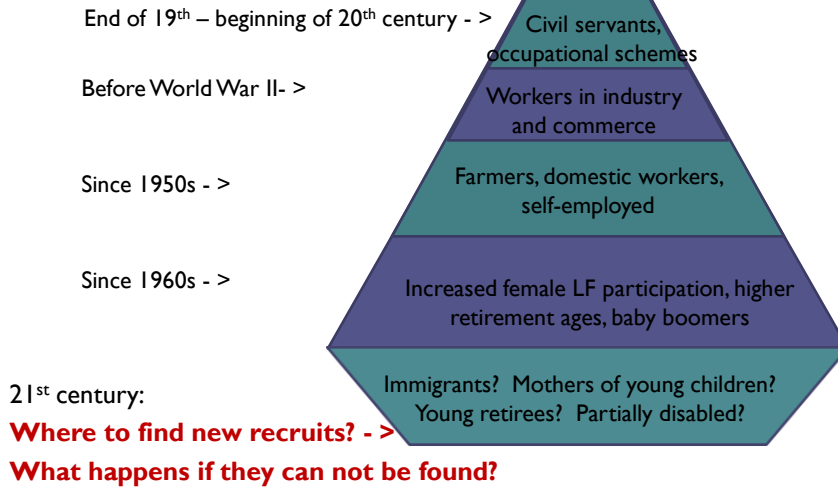
## These Factors Add up to significant Increase in Future Obligations



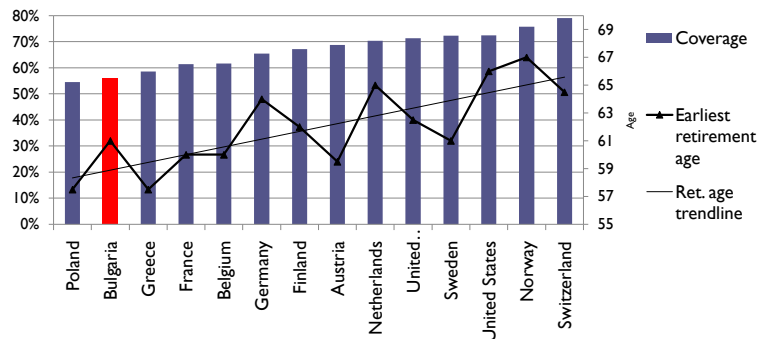
*Before dismantling the second pillar, useful to have social dialogue on other options*

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

## Is Status Quo Fair / Sustainable?

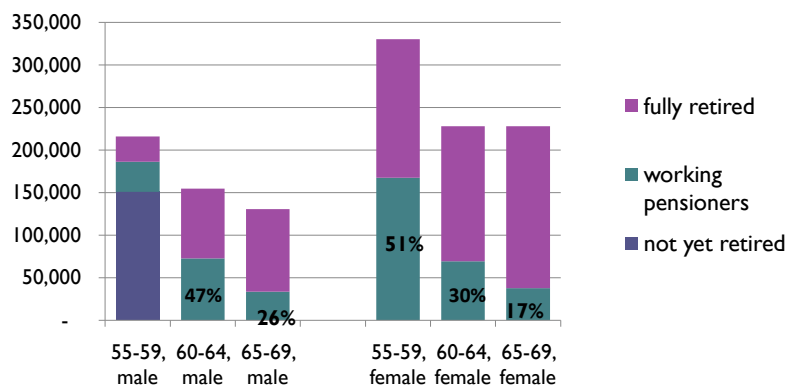


## Coverage & Retirement Age, Selected Countries



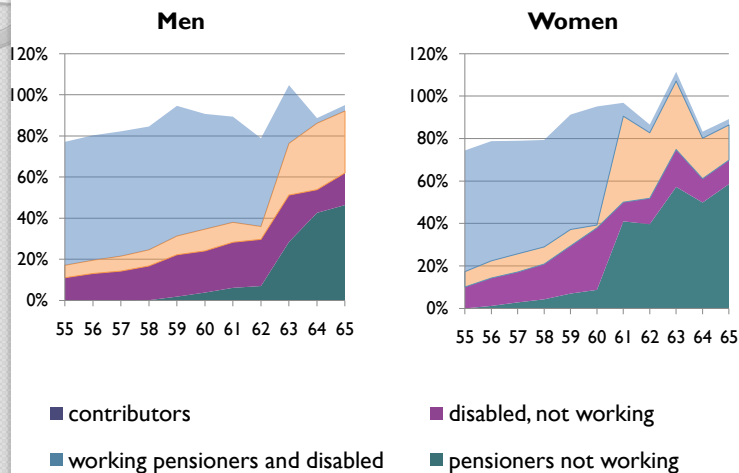
- Coverage is typically calculated as number of contributors over population aged 20-65
- Surest option to increase coverage statistic is to increase retirement age

## Belarus: Majority of People at Current Retirement Age Are Able to Work



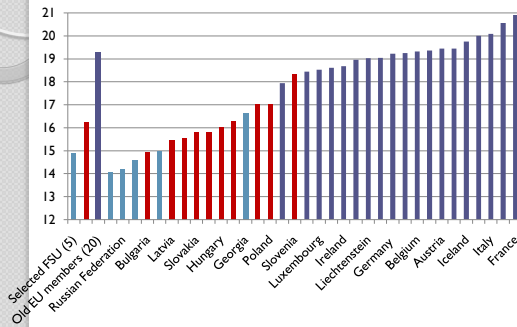
- 71% of early retirees continue to work (why have this scheme at all?)
- Disability and unemployment programs would provide a safety net

## Lithuania: 50% of Population Continue Working after Reaching Retirement Age



## Life Expectancy at Age 65

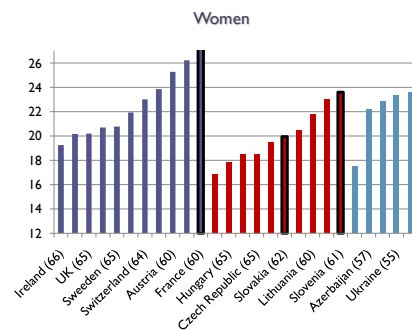
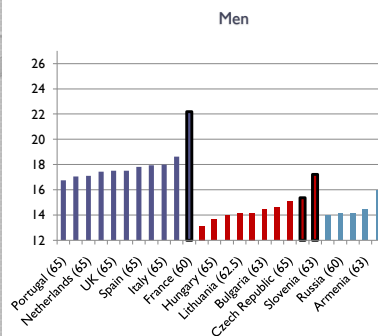
EuroStat, 2007



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

## Life Expectancy at Statutory Retirement Age

EuroStat, 2007



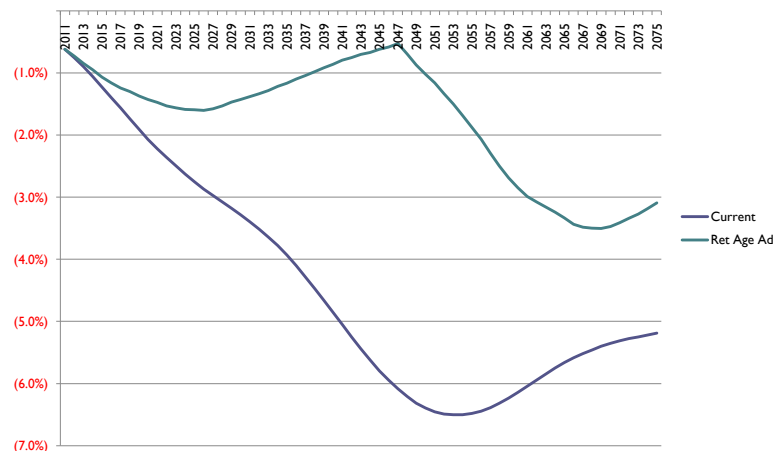
- New EU member states and FSU can not afford retirement lengths of old EU members; even old EU members can not afford them and are starting to reform
- Gender difference in old member states: **4.6**; new member states **5.4**; FSU: **7.4** years

## Raise Retirement Ages

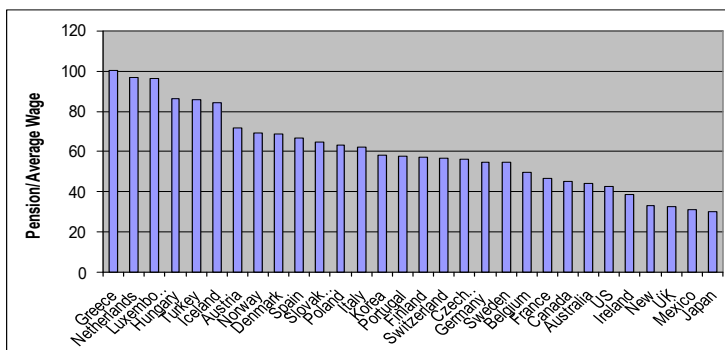
- Need a social consensus that people cannot continue to retire young
- May need to consider modifications more applicable to an aging workforce – for example, part-time work, pay scales, etc.
- May need to include lifelong learning and retraining opportunities
- Clearly a win-win-win proposition
  -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

## Raise Retirement Ages to 70 by 2047

Projected Deficits with Retirement Age Increase

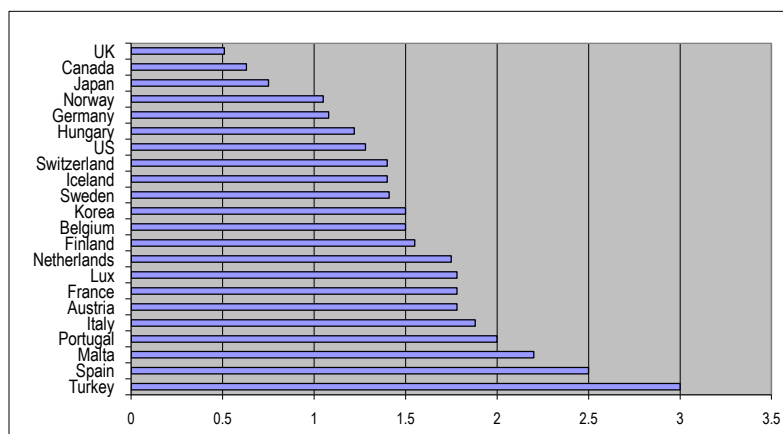


## OECD: Average Pension / Net Average Wage for Full Career Workers looks generous, but...

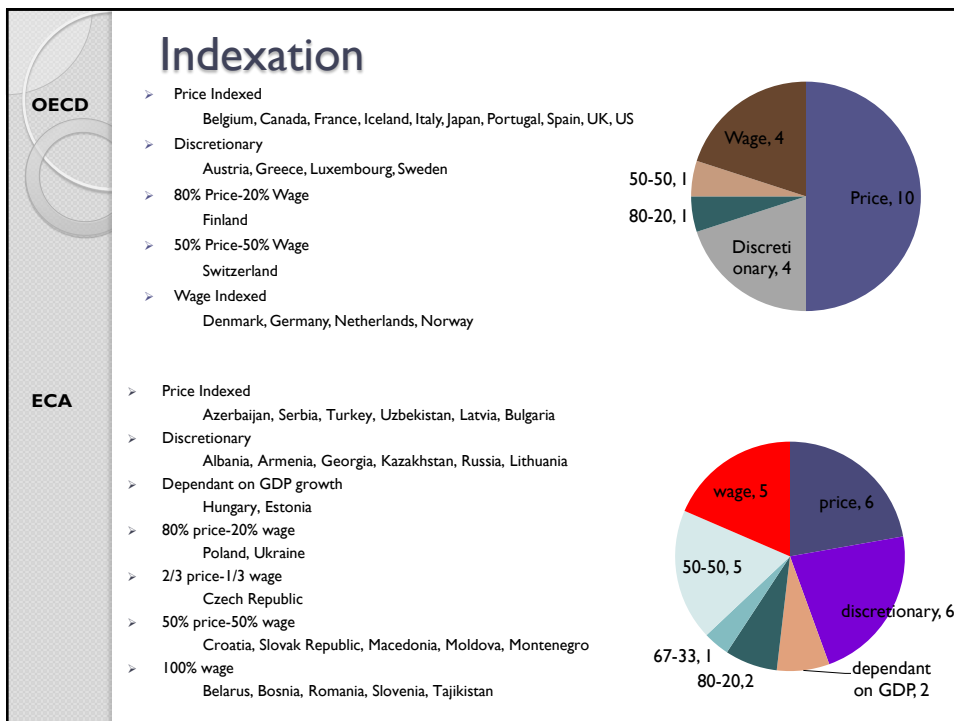


- Requires 45 year career
- Many of these OECD schemes are not sustainable and will have to be reformed

## OECD Accrual Rates



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



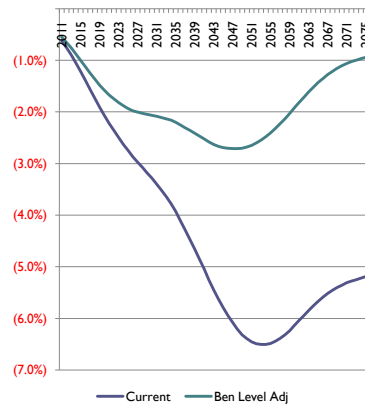
## Changes in Pension Indexation

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

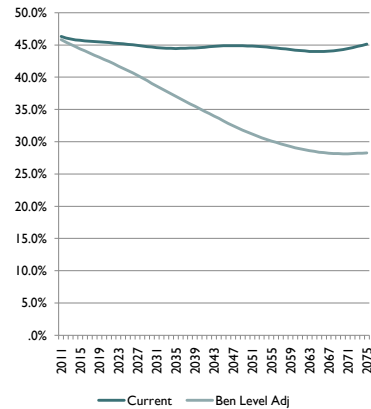


## Reduce Benefit Levels By Approximately 40%

**Projected Deficits with Benefit Decrease**



**Projected Benefit Levels Relative to Average Wage**



## Funded Pillar

- Diversification of risk is still relevant
  - *Timing of shocks to financial asset prices considerably different than timing of crisis on PAYG benefit levels*
- Aging of population
  - *Benefit levels will likely fall further in the future*
  - *To maintain adequacy of benefits, will need to save either on voluntary or mandatory basis*
- But need to have adequate preparation
  - *Fiscal space*
  - *Adequate financial markets*
  - *Adequate supervision and regulation*

## Forthcoming World Bank Report

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

Thank You