PANEL 4

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Ukrainian Pension Reform in The Light of European Practice

CEE countries – pension reforms and reversals

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**The statements included in this presentation represent the views of the author.*

Introduction of funded pillars in CEE countries

	Public pension scheme (PAYG)	Retirement age	Mandatory Funded Scheme		
			Initial contributions	Enactment date	Who participates
Bulgaria	DB	60/55 to 63/60	2% to 5%	2002	Mandatory for all workers <42, no cohorts with choice option
Estonia	DB	60/55 to 63/63	6% (4% +2%)	2002	Mandatory for new entrants, voluntary for 19-60 in year of reform
Latvia	NDC	60/55 to 62/62	2% to 8%	2001	Mandatory for new and workers < 30, voluntary for 30-50
Lithuania	DB	60/55 to 62.5/60	2.5% to 5.5%	2004	Voluntary for current and new workers
Hungary	DB	60/55 to 62/62	6% to 8%	1998	Mandatory for new entrants, voluntary for all employed
Poland	NDC	65/60 (60/55) to 67/67	7.3%	1999	Mandatory for new and workers < 30, voluntary for 30-50
Romania	DB	62/57 to 65/60	2% to 3%	2008	Mandatory for new and workers < 35, voluntary for 36-45
Slovakia	Points	60/53-57 to 62/62	9%	2005	Mandatory for born after 1983, voluntary for all being in the social insurance before 2005

Source: Bielawska K., Chłoń-Domińczak A., Stańko D. (2017). Retreat from mandatory pension funds in countries of the Eastern and Central Europe in result of financial and fiscal crisis: Causes, effects and recommendations for fiscal rules

Reversals of funded pillars in CEE countrie

Country	Start of new system	Changes
Bulgaria	2002	No changes (but defended by Constitutional Tribunal)
Estonia	2002	**Temporary reduction, followed by temporary increase** Contribution of 6% lowered to 0% since Jun 2009 until Jan 2011 (sent to PAYG pillar) Gradual increase from 2011 – 3% in Jan 2011, 6% in Jun 2012, 2014-2017 8% to make up for unpaid contributions in the past
Latvia	2001	Partial reduction Contribution 8% lowered to 2% in May 2009. Contribution increased to 4% since 2014.
Lithuania	2004	Partial reduction, followed by temporary increase Contribution of 5.5%, reduced to 2% in Jul 2009. Further reduced to 1.5% in Jun 2012. Increased to 2.5% in 2013. Changed to 3% (2% mandatory + 1% voluntary) since Jan 2014 and voluntary participation. Additional 2% contribution was in force during 2016-2019 to make up for reduced contributions in the past.
Hungary	1998	Permanent reversal Contribution lowered to 0% from Jun 2011, assets moved to PAYG.
Poland	1999	Partial reduction and partial reversal Contribution of 7.3% lowered to 2.3% in May 2011. From Feb 2014 contribution set at 2.92%, in Feb 2014 assets invested in government bonds transferred to PAYG and redeemed. In 2014 system is voluntary with opt-out and opt-in in specified time slots. Assets from pension funds are gradually transferred to PAYG 10 years prior to retirement.
Romania	2008	Partial reduction Planned growth path for contribution from 2% to 6% was deferred. Contribution rates in 2008 – 2%, 2009 – 2.5%, 2010 – 3%, 2011 – 3.5%, 2012 -4.0%, 2013 – 4%, 2014 – 4.5%, 2015 – 5%. In 2016 increased to 5.1% instead of planned 6%, stayed at this level in 2017. In 2018 decreased to 3.75%.
Slovakia	2005	Partial reduction Contribution of 9% decreased to 4% in 2013. In 2017 increased by 0.25% with a plan to reach 6% in 2024. Funded scheme became voluntary in 2008, with possibility to change decision every 2 years since 2009. Default opt-out for new workers with possibility for them to opt-in until 35 y.o.

Source: Bielawska K., Chłoń-Domińczak A., Stańko D. (2017). Retreat from mandatory pension funds in countries of the Eastern and Central Europe in result of financial and fiscal crisis: Causes, effects and recommendations for fiscal rules

Reasons for withdrawals?

- **fiscal situation**: transition debt that was not financed as planned
  - initial plans to achieve savings in pension system (early retirement, privileged groups, higher retirement age) never worked out
  - transition debt: Poland 2001-2015 – 17.4% GDP, Bulgaria 2002-2015 13.0%, Estonia 2002-2015 11.2%, Slovakia 2005-2015 10.7%, Hungary 2001-2010 9.9%, Latvia 2001-2015 6.7%, Lithuania 2004-2015 6.4%, Romania 2008-2015 4.6%
  - only Latvia financed most of the costs by finding savings in pension system; others – mainly increase public debt
- political economy: pension funds the 'bad guys' (fees, returns, charging fees for predominantly Treasury Bond investments, high returns by CEE pension managing companies especially in times of crisis with funds losses sometimes as high as 30-70%)
- performance was not the real reason – at least for Poland and Hungary

Table 7. 1. Summary: social, economic and fiscal context of pension reform reversals

	Fertility	Dependency rate	Employment	Pension expenditure	Pensioners	Performance of funded Pension fund returns	Government deficit	Government debt	Pension system changes after crisis
Bulgaria	-	-	+	+	+	-	-	+	**No change**
Estonia	-	-	+	+	+	-	+	+	**Temporary reduction with offset**
Latvia	--	--	-	-	-	-	--	-	**Partial reduction**
Lithuania	-	-	--	+	+	-	--	-	**Partial reduction**
Hungary	--	-	-	--	-	+	-	--	**Permanent reversal**
Poland	--	--	++	--	-	+	--	--	**Permanent reduction and partial reversal**
Slovakia	--	--	++	-	-	-	--	--	**Permanent reduction**

Source: Bielawska K., Chłoń-Domińczak A., Stańko D. (2017). Retreat from mandatory pension funds in countries of the Eastern and Central Europe in result of financial and fiscal crisis: Causes, effects and recommendations for fiscal rules

Conclusions (Bielawska et al., 2017)

1. It is not (transition) cost that made governments to reverse funded pillars. The reason was fiscal and demographic/labour situation and obviously, pension expenditures were just an additional burden.

2. The reversals brought about a lack of social trust

3. No conclusions whether the reversals increased volatility of financial markets. Nevertheless, the case of Poland shows that the role of pension funds as domestic investors in TBs have been greatly reduced and this may create problems if any exchange rate crisis occurs in the future.

4. Only in Poland future pensions will be lowered because of the reversal. Other countries – either no much change (Baltic States) or will increase (Slovakia).

5. Only in Poland future pension expenditures will increase. Other countries – they will be lowered. However, there could be other factors than reversals only that influence the level of expenditures: modification of pension formulae, increase/change of retirement age, indexation of pension benefits or accrued rights, calculation of insurance period, early retirement etc.

5. Financial stability has improved but… in most of the CEE countries, the effect of the increase in public pension expenditures related to the acquisition of all or a part of the contribution from the second pillar will emerge in the years beyond the forecast horizon (after 2060).

7. A compromise between solving fiscal tensions and maintaining a significant role of mandatory funded pillars would have to involve considerable changes in the fiscal rules in the EU, the Eurostat classification methods of pension debt and countries internal public finance laws.

Some thoughts in the context of Ukraine

1. Costs of funded pillar are essential (administration, investment, marketing)
2. Develop political consensus to make the system more resistant from reversals. Strong fiscal rules to rationalise pension expenditures in public system could help.
3. Public trust - don't allow for creating unrealistic expectations amongst public – have a look at the marketing campaign and public campaign („Pensions under the palm trees" - пенсії під пальмами)
4. Make sure funded system is not an expensive version of PAYG system (i.e. the share of domestic treasury bonds should not be overwhelming)
5. Information and education on pension issues should be treated as a public good