Ukrainian Financial Forum

PANEL 4

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Ukrainian Pension Reform in The Light of European Practice

Learning from Pension Privatization Failures in Eastern Europe

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Something went wrong…

Country	2nd Pillar Inception	Reform Reversal
Hungary	1998	Dismantling, 2010
Poland	1999	Dismantling, 2013
Latvia	2001	Scale-down, 2009
Bulgaria	2002	Scale-down & Back-to-PAYG, 2011
Croatia	2002	Back-to-PAYG, 2009, 2018
Estonia	2002	Temporary reduction in 2009
Lithuania	2004	Scale-down, 2010
Slovakia	2005	Scale-down & Back-to-PAYG, 2009
FYR Macedonia	2006	Scale-down, 2014
Romania	2008	Scale-down, 2018
Czech Republic	2013	Dismantling, 2014

- **Reform reversals in 10 out of 11 countries**

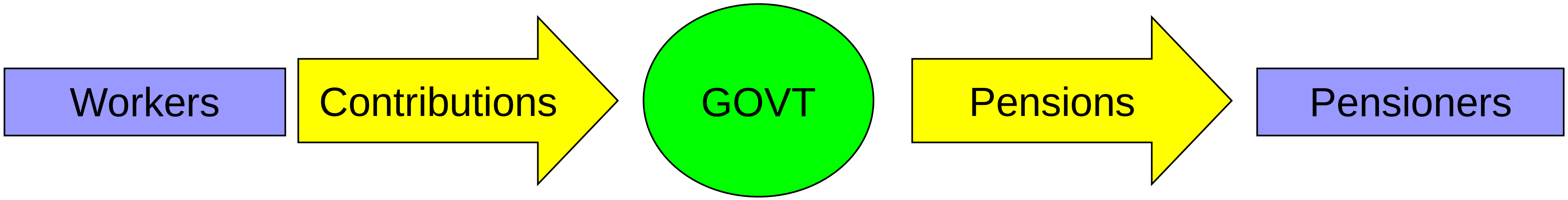
Lesson #1: Pension reform is about Pensioners! Period.

- Nothing to do with economic growth, capital market development or combating shadow economy
  - Distinguish lobbying from firm evidence
- Needs inclusive process & broad support
  - Support needed for 50 years until funding matures
- Beware of vested & conflicting interests
  - Financial industry, World Bank

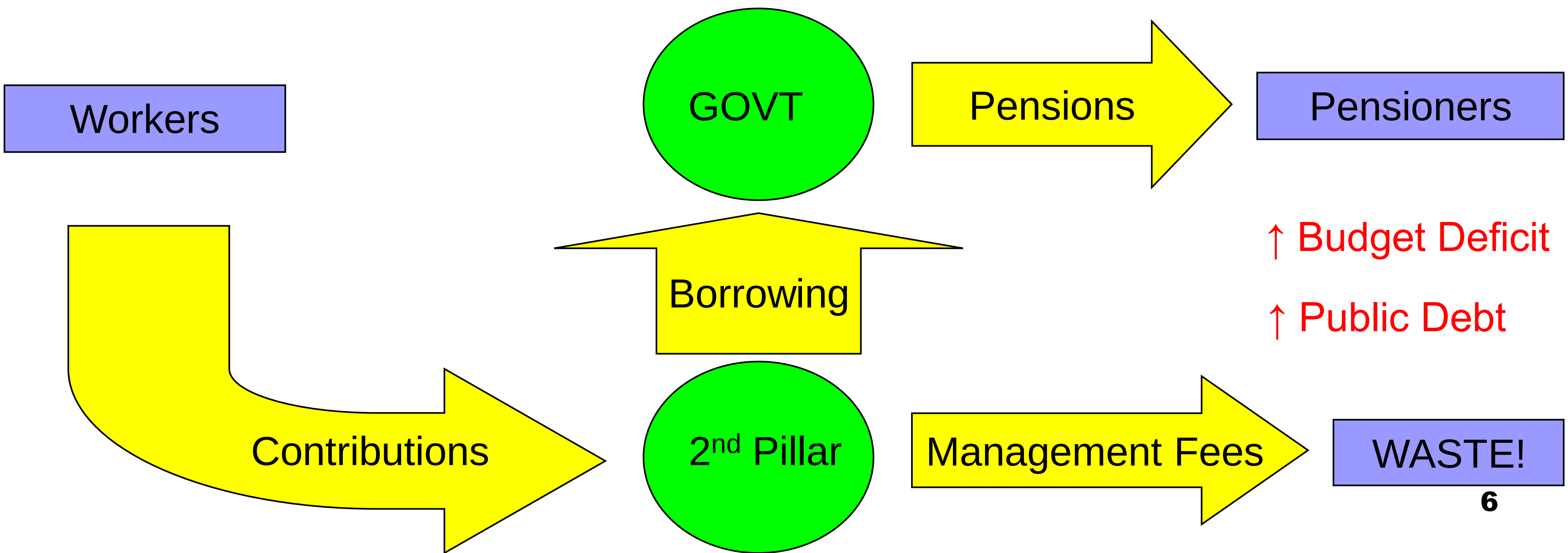
Lesson #2: Don't Carve-out Funded Pensions from PAYG

- Private pensions developed to supplement public PAYG benefits in Western Europe, North America
- 2nd pillar carved-out from existing PAYG systems in Eastern Europe and Latin America
  - 40 to 50 years of large transition costs
- Austerity measures missing in most countries
  - Chile ran surpluses of 8% of GDP over 1980-2000's
  - Domestic gov't bonds accounted for:
    - ~60% of assets in Argentina, Hungary, Poland, Macedonia
    - ~70% of assets in Croatia, Romania, Uruguay, Costa Rica, Dominican Republic, El Salvador

Standard PAYG Financing



Carve-out Privatization without Austerity



Lesson #3: Choice and Competition are not Panacea

Country	Individual Accounts		GDP		2nd Pillar Rate Reduction
	Real returns	Standard deviation	**Growth**	Standard deviation	
Latvia	-0.6	7.7	3.5	6.7	10% -> 6%
Bulgaria	1.6	8.3	3.5	3.2	7% -> 5%
Estonia	0.5	10	3.0	6.4	Temporary
Lithuania	1.4	10.2	3.0	6.1	5.5% -> 2%
Slovakia	-0.1	3.5	3.8	4.1	9% -> 4%
AVERAGE	**0.6**	7.9	**3.4**	5.3	Decrease by **2.9 pp**

- Asset fees 1.5% in Latvia and Estonia, 1% in Bulgaria and Lithuania, 0.3% in Slovakia
  - Evidence of inflated second floor fees
- Often blamed on unsupportive preconditions in developing countries
  - Lack of financial literacy, poor supervisory capacities, undeveloped markets, oligopoly structures

Lesson #3: Choice and Competition are not Panacea

- Mandatory individual account systems dismissed in virtually all developed countries
- Look at Australia as a counter-factual
  - Not-for-profit (occupational) funds returns = 4.7%
  - For-profit retail funds = 2.3%, over 1997-2017 period
  - Workers not switching and retail funds maintaining their 40% market share despite significantly lower pensions
- Market failures inherent with individual accounts
  - Hard to find good remedies
  - Look at default life-cycle portfolio in Sweden