Old-Age Pension Reform

A Review of Selected Countries

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One of the major topics for reform involving income support for elderly persons following the collapse of the communist regimes in Eastern Europe has been public old-age pension systems. This article briefly discusses four of the more important factors that have helped to shape policy goal and strategies of reform in the Czech Republic, Hungary, Poland, Latvia, and the Russian Federation. The basic provisions for old-age pensions are also summarized.

The factors discussed here are constantly evolving in the sense that many of the policies proposed during the first stages of the economic, political and social transition have constantly been revised in the face of fiscal and structural realities. The development of old-age pension policies is uncertain, but there are discernible trends emerging that shed light on the likely direction of pension systems and make for an interesting point of departure for considering both established and potential reform measures. It is also important to note that the reforms mentioned in this report are often the first, but not necessarily the latest, reforms under discussion since policies are in a relatively unstable state of development and transition.

In any discussion of old-age pensions in Eastern Europe, caution must be exercised to avoid conveying the notion that the systems in place under the communists were homogeneous or that they are now converging toward a uniform approach. While there were and are similarities, the systems of each country uniquely reflect their pre-socialist government and social foundations, as well as their current distinctive needs and resources.

At the risk of oversimplifying the complexity of pension reform in the transition economies, four factors that seem to have been particularly influential in policy planning are discussed in this article: political support, capital formation of public and private savings, high tax rates, and social assistance.

Efforts to use old-age pension reform to gain public political approval appear to play a major role in old-age pension policy development. Many policy makers initially adopted the posture that the implementation of western models of social security would result in similar old-age pension program standards that are found in Western Europe and Canada. More recently, this view has been moderated somewhat by arguments for systems that are more reflective of national characteristics and available resources. Nevertheless, it is still fashionable to promote the idea that the western model of old-age pensions, as a part of reforms in all social security programs (unemployment benefits, cash sickness and maternity benefits, health care, workers compensation, family benefits), will lead to comparably higher benefits under a more comprehensive and equi-
Russians of pensionable age (55 for women and 60 for men) have become increasingly vulnerable during the transition to a market economy. The continuing high rate of inflation has led to their growing poverty rate and almost one-half of them currently live below the poverty line. The minimum monthly pension is now 26,000 roubles (US$16) while the minimum subsistence income is estimated to be 111,000 roubles (US$55) and the average monthly salary runs about 227,000 roubles (US$114).

A second factor behind old-age pension reform proposals is the desire to use an old-age pension system's capacity to generate capital, accumulated in a trust fund, that might be used to finance projects that contribute to general economic growth and development. This goal has helped to shift much of the debate on old-age pension reform toward measures of capital formation through old-age pension trust funds. This approach is typically linked to private (occupational) pension options that would also put more money into the economy through increased personal savings.

Very little progress on trust fund accumulation or private options has been made. Most of the old-age pensions systems have adopted a pay-as-you-go approach to funding similar to the operating principles of the compulsory, contributory social insurance systems of most western European countries. Under this approach, old-age pension financing is largely an inter-generational transfer of funds from working to non-working generations. Thus, trust funds remain a modest source of capital. Moreover, there is reason to question if capital formation will become a viable aspect of pension funds in the foreseeable future.

Nor has there been any significant development of industrial private pension schemes to supplement public old-age systems of income support. One problem has been that there are no pre-existing legislative or legal frameworks, which are essential components for an effective system of private pensions. (As noted below, Hungary has recently taken some action in this regard). There is also a conceptual issue that is particularly difficult to overcome in societies that relied heavily on government to provide economic protection for retirees with no visible risk to the worker. Most proposed private pension programs are based on the principle of defined-contribution where the prospective pension benefit amount is related to the contributions paid into the fund. Thus, the risks of inflation or poor investments returns are assumed by the future pensioner. This contrasts with public schemes that are based on the principle of defined-benefit (pensions are related to a proportion of earnings) where risks are shared between employee and employer or assumed by the employer.

A closely related aspect of the interest in greater privatization is the discussion on the contrasting virtues and inappropriateness of the Chilean model. Although there has been some support for this approach, many experts in social security warn against its endorsement.

A third factor in policy reform is that payroll contributions for old-age pensions are viewed in the context of efforts to reform all cash benefits under comprehensive social security provisions. When combined with payroll taxes to finance unemployment benefits, work injury benefits, cash sickness and maternity benefits, health care, and family allowances, the total tax package dampens enthusiasm for costly reforms.

A fourth factor in discussions of old-age pension reform is the consideration of the role of social assistance as a safety net for income security. Support for this approach stems from the presumption that resources can