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The Implications of „Averting the Old-Age Crisis" for Pension Systems in Central and Eastern Europe and What the Future Holds?

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7th International Pension Research Association Conference
June 23, 2022

Cycle of pension system changes in CEE countries: shifting perspectives

From transition to enlargement: towards convergence to market economy → EU accession and post-accession: rebalancing the pension systems → Financial and economic crisis: back to dominant role of the PAYG

Initial conditions

- Economic and social transition after the fall of the centrally planned economy

- Changing labour market:
  - Rising unemployment in early 1990s
  - Restructuring of the employment structure
  - More frequent job changes
  - Outdated skills

- Widespread early retirement
- Rising costs and deficit in pension systems

- Demographic change
  - Sharp drop in fertility rates causing fast population ageing in the future
  - Gradually increasing life expectancy

Towards multi-pillar schemes: externalities

- Need to support financial market development
- Establishing domestic institutional investors
- Encouraging long-term savings

Seeking the new model: multi-pillar pension reforms

Shifting to funding....

- 1998: Hungary
- 1999: Poland
- 2001: Latvia
- 2002: Bulgaria, Estonia
- 2004: Lithuania
- 2005: Slovakia
- 2008: Romania

... and diversity of approaches in public systems

Country	*Type*	*Country*	*Type*
BE	DB	LT	PS
BG	DB	LU	DB
CZ	DB	HU	DB
DK	Flat rate + DB	MT	Flat rate + DB
DE	PS	NL	Flat rate + DB
EE	PS	AT	DB
IE	Flat rate + DB	PL	NDC
EL(1)	Flat rate + DB + NDC	PT	DB
ES	DB	RO	PS
FR(2)	DB + PS	SI	DB
HR	PS	SK	PS
IT	NDC	FI	DB
CY	PS	SE	NDC
LV	NDC	NO	NDC

Source: Ageing Report 2021

Funded tiers: contributions and financing transition

Contributions to funded tiers

Bulgaria	2% ↗ 5%
Estonia	6% (4% +2%)
Latvia	2% ↗ 8%
Lithuania	2.5% ↗ 5.5%
Hungary	6% ↗ 8%
Poland	7.3%
Romania	2% ↗ 3%
Slovakia	9%

Financing transition

- Three sources of financing transition costs:
  - increase of the general government debt =>future generations).
  - financing from **taxes** and other budgetary revenues => working generation,
  - financing from **savings in the existing PAYG** system => retired generation

- Perceiving transition cost:
  - Increased explicit GG debt
  - Shifting from implicite to explicit liabilities

Shifting perspective: EU accession and 2008 crisis

EU accession

- Open Method of Coordination:
  - Adequacy and sustainability of pension systems
  - Ageing Reports
  - “Traditional” models in the old member states:
    - occupational funded systems,
    - no individual mandatory funding (except SE)
- Stability and Growth Pact:
  - Limits on budget deficit and general government debt
  - Only temporary exemption of transition cost

2008 economic and financial crisis

- Economic recession (except PL)
- Rising budget deficits and general government debt
- Lower revenue of pension systems, thus higher deficit

Transition costs

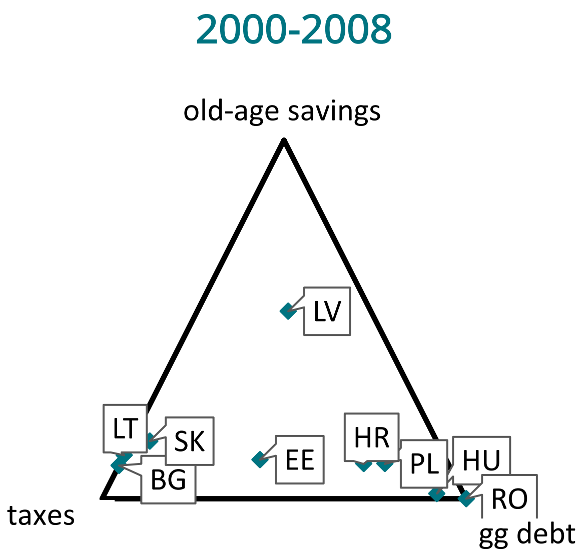
- Transition costs gradually
  - increased contributions and/or
  - higher coverage of the mandatory pension system due to the new entrants

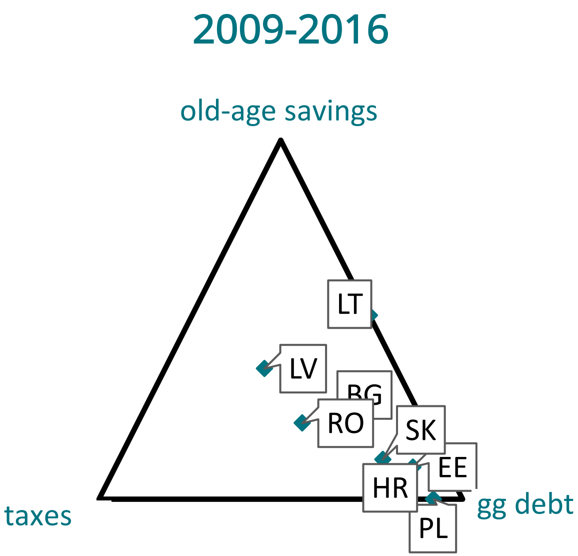
- Reversals/reductions led to temporary or permanent decline of transition costs:
  - 2009: LV, LT
  - 2010: EE, BG
  - 2011: HU, PL
  - 2013: SK

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
BG			0.6	0.5	0.6	0.7	0.8	1.1	1.1	1.1	1	0.9	0.9	1.3	1.1	1.3	1.3
EE			0.0	0.4	0.6	0.7	0.7	0.8	0.5	1.1	0.1	0.4	0.9	1.4	1.8	1.9	2.0
LV		0.1	0.2	0.4	0.4	0.6	0.7	1	1.1	0.1	0.1	0.1	0.1	0.5	0.5	0.8	1.1
LT					0.3	0.4	0.6	0.9	1.1	0.6	0.3	0.4	0.4	0.4	0.5	0.5	0.8
HU	0.5	0.5	0.5	0.7	0.8	1	1	1.2	1.2	1.4	1.1						
PL	1.0	1.1	1.2	1.2	1.1	1.3	1.4	1.4	1.6	1.6	1.6	1.0	0.5	0.7	0.5	0.2	0.2
RO									0.2	0.3	0.3	0.4	0.5	0.7	1	1.2	1.3
SK						0.6	1.1	1.2	1.2	1.2	1.2	1.2	1.1	0.6	0.6	0.6	0.7
HR			0.9	1.1	1.1	1.2	1.2	1.2	1.3	1.4	1.4	1.4	1.5	1.5	1.5	1.5	1.5

Source: Bielawska et al. (2018) with updates

Financing of the transition costs





- Before the crisis
  - transition financed mainly from taxes/debt, with notable exception of LV
  - Public debt used to finance transition in PL, HU, RO

Source: Bielawska et al. (2018) with updates

- After the crisis
  - Transition financed from debt in PL, EE, SK, HR
  - Old-age pension savings used to finance transition in LT, LV, BG, RO
  - Tax-financing less popular

Pension developments in CEE countries

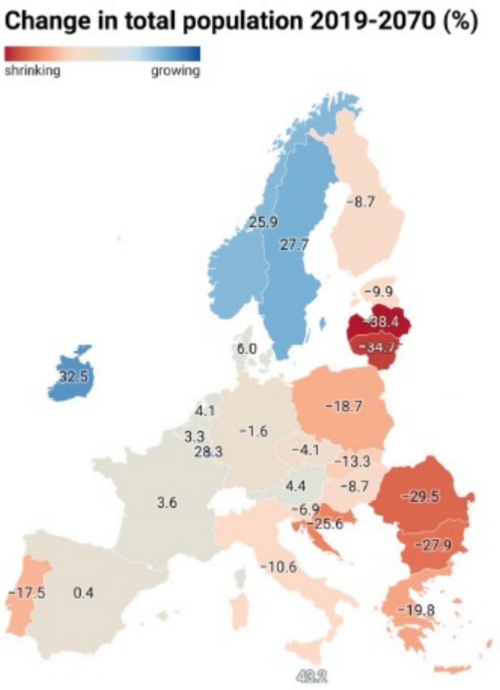
- Reversals of pension reforms were caused by a set of country-specific socio-economic factors, including most importantly
  - poor fiscal situation
  - rising pressure from current pension system expenditure

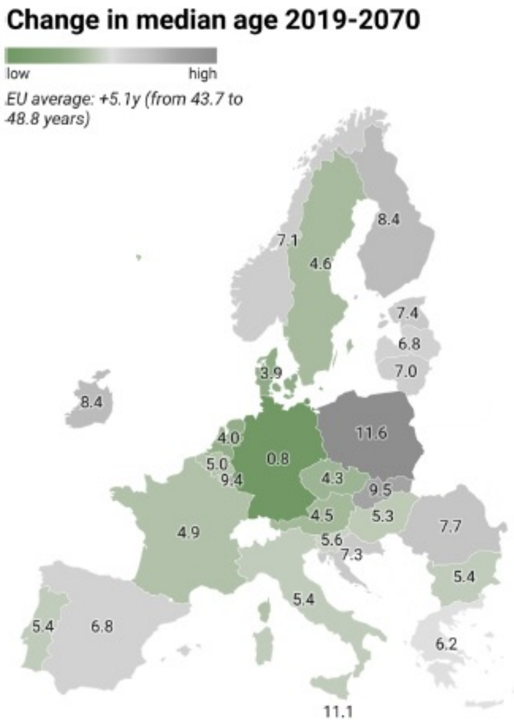
- Performance of pension funds had little impact on reversal decisions

- Permanent reversals and reductions were made in countries with highest demographic pressures foreseen in next decades

What the future holds?

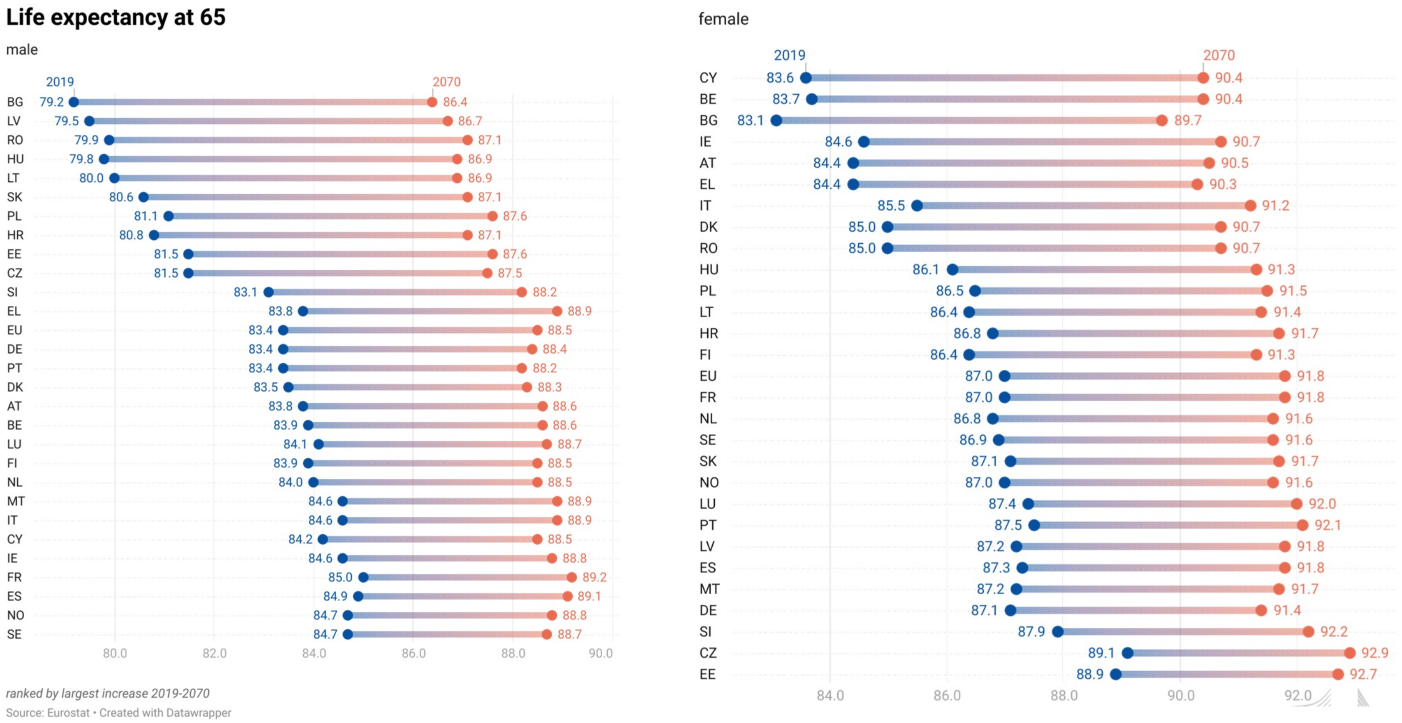
Ageing remains a challenge…





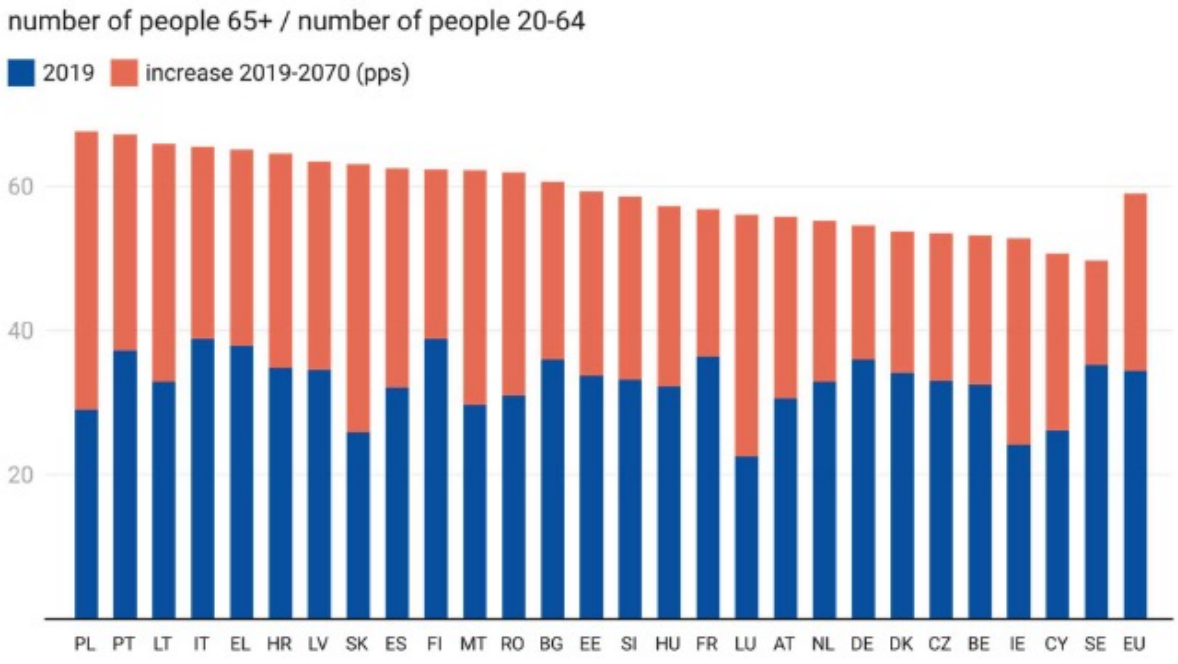
Source: Ageing Report 2021

Life expectancy increasing



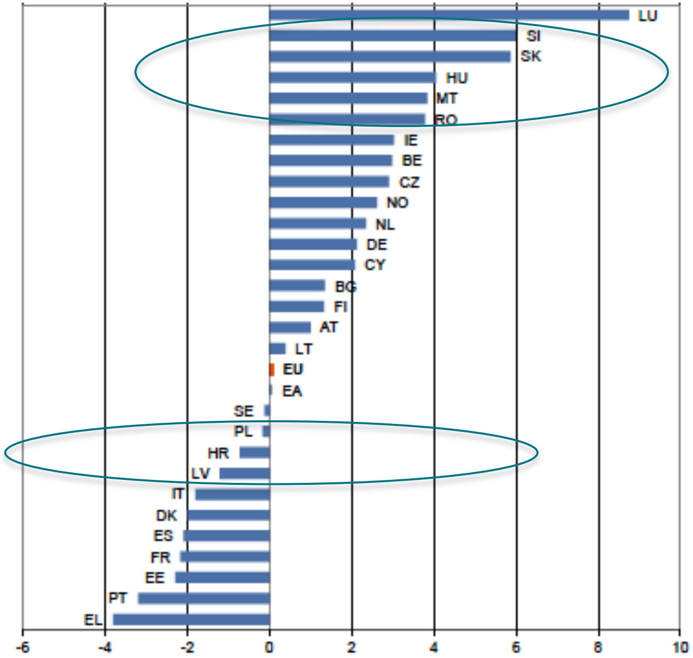
Source: Ageing Report 2021

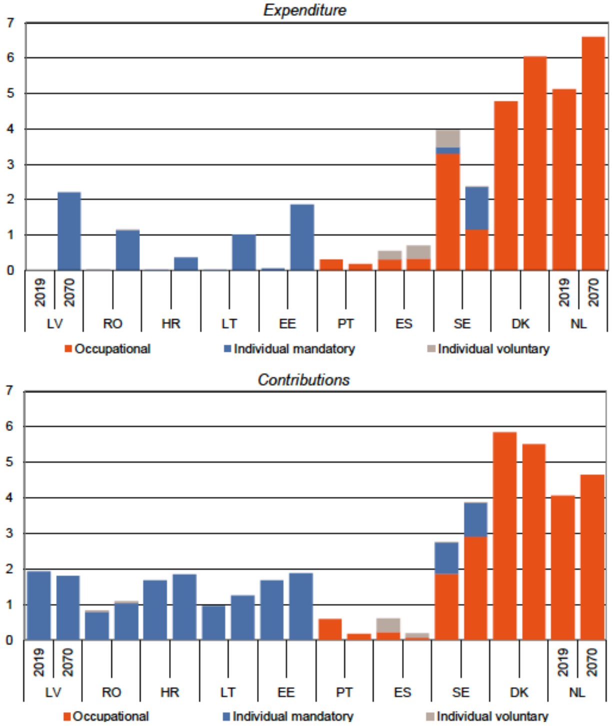
Dependency ratios rising fast in CEE countries



Source: Ageing Report 2021

Changing pension expenditure and the role of funded pensions

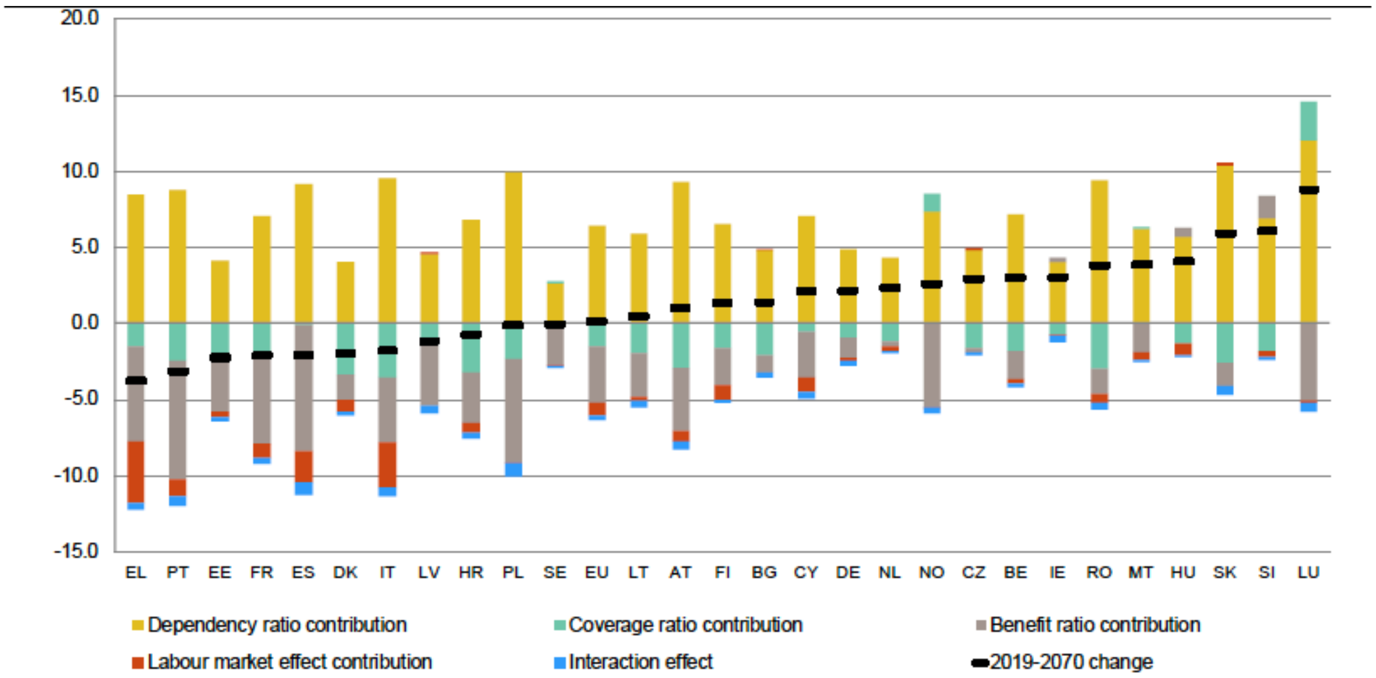




Changing retirement age

	Retirement age
Bulgaria	60/55 → 63/60 → 65 → 67
Czechia	60/57 → 65
Croatia	65/60 → 65
Estonia	60/55 → 63 → 65 + life exp
Latvia	60/55 → 62 → 65
Lithuania	60/55 → 62.5/60 → 65
Hungary	60/55 → 62 → 65
Poland	65/60 (60/55) → 67/67 → 60/65
Romania	62/57 → 65/63
Slovenia	62/55 → 65
Slovakia	60/53-57 →64

Contributions to change in pension expenditure



Averting the old-age crisis in CEE?

- Countries with projected decline in pension expenditure:
  - Increase retirement age
  - Reduce replacement levels

- Countries with projected increase in pension expenditure:
  - Increase retirement age
  - Moderately or not at all reduce replacement levels