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Pension Systems' Privatisation in Central and Eastern Europe[2]

Abstract

Introduction of the second pension pillars in Central and Eastern European countries represents a unique political, social and economic experiment. This paper offers the overview of this paradigmatic shift, taking into account both domestic factors, the role of international financial institutions and the European Union. Ten out of eleven countries — newcomers to the European Union — decided to implement it. Slovenia stayed aside from the beginning. Poland, Slovakia, Latvia, Lithuania, Estonia, Croatia, Bulgaria and Romania offer a rich and diverse trajectory of the time and conditions of its introduction, further development, in some instances retrenchment, and the scope of benefits for retired insured persons. Hungary was a pioneering country, but later on, it left the camp and dropped this option. The issue the paper deals with is the case of the

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Czech Republic in more detail. The country was a latecomer, opted just for its voluntary version, and cancelled it completely again just after three years of operation. Concluding remarks address the emerging experience with reform outcomes and a potential role of the European Union as one of the actors influencing pension reforms in the region.

Key words: pension systems, privatisation, central and eastern europe, european union

Introduction

In his seminal book on Welfare States' transitions, Esping-Andersen (1996) noted that East and Central Europe was clearly the most under-defined region, a virtual laboratory of experimentation. If not generally, this is certainly true about pension systems in the region. The most visible structural changes are embodied in the introduction and — in most cases — consecutive retrenchment of compulsory privately funded pension schemes, the so called second pillars of pension systems. After thirty years after the collapse of communist regimes, it is possible to try to reflect these reforms in a comparative perspective and draw more general conclusions about external and internal determinants of such developments.

Initial conditions and external context of pension reforms in the region

The failure of the Soviet-type state socialism at the end of the 1980s found its reflection in people' minds. The idea of social solidarity and its instrument — a publicly delivered social policy — was quite discredited in the region. Explicitly or implicitly, national governments wanted to prepare their countries to the demands of market economy and political democracy by privatising social services and diminishing coverage and level of social benefits, which were often interpreted as dispensable relics of the communist regime. In addition, as they all desperately needed to enter global economy, they found themselves in the situation of mutual competition for foreign investment, interpreted as competitive policy signalling. Privatising the pension systems was used as the tool which was seen fully appropriate to legitimize this policy orientation.

This U-turn domestic changes coincided with external conditions, namely with the ideological influence of the "Washington Consensus", a form of neoliberal orthodoxy applied to pension systems, above all, by the World Bank, accompanied by the International Monetary Fund and International Bank for Reconstruction and Development (World Bank, 1994; Holzmann and Hinz, 2005; Holzmann, 2009). The core of their advice was to diversify the pension systems by strengthening their privately funded components at the expense of traditional public mandatory pay-as-you-go schemes. As argued by several authors, these international actors took advantage of their strong negotiation positions vis-à-vis the indebted and inexperienced national governments and inefficient Central and Eastern European economies inherited from the communist past to push through their neoliberal ideas (Deacon, 2000; Ferge, 2001; Orenstein & Haas, 2003; Orenstein, 2013). Apart from privatising the national public social security schemes, they also push government to similar privatisation moves in health care provision and education and transform social welfare into a residue of itself.

Various authors share the opinion that pre-accession efforts and subsequent membership in the European Union affected and changed the different countries' welfare systems as well. At the same time, most authors regard the role of the European Union in the shaping of national social policies as weak and marginal.

The history of candidate countries' systematic preparations for accession to the European Union began with the codification of the Copenhagen accession criteria in 1993. The criteria were designed as a technical (economic and political), top-to-bottom instrument, rather than a suitable tool for shaping the welfare situation of people living in the candidate countries. Legal, economic and political issues prevailed. The candidate countries were required to reform their national economies in order to converge and become competitive with existing member states' market economies. They were expected to build robust and reliable institutions of political democracy. As one of the necessary conditions, they had to adapt their national legal and administrative systems to the demands of *acquis communautaire* and be able to implement it in practice. Social welfare goals were limited: there was a loosely defined demand to respect individual human rights. Thus, to build a framework for adequate social policy making adapted to a changing economic and political context was very low on national policy agendas.

Issues like poverty, income inequality, workers' rights, subsistence minimum and easing the lot of groups on the margins of society — in other words, fight against social exclusion — were not an explicit part of the Copenhagen reform agenda. The national social policies of most candidate countries in the 1990s actually focused on reducing the role of the state and raising economic efficiency.

Greater emphasis on the social aspects of the European Union policy was strengthened as late as in the dawn of the new Millennium. The European Council adopted the Lisbon Strategy (2000) as a strategic outlook for the entire decade, and the social dimension of the European integration process became an important part of the Lisbon Strategy at the Nice Summit. This was probably also caused by the growing power of the Party of European Socialists in the newly-elected European Parliament. This was a stream of new policy initiatives emphasizing the importance of human resources, quality of life and social cohesion, i.e. the social fabric of European societies. However, by the Barcelona Summit of 2002 when the first candidate countries were finally invited to Lisbon-related negotiations, their preparations for accession organized in line with the Copenhagen criteria were practically concluded. Full participation in the Lisbon Strategy began after their accession. Thus, social policy assumed a more important role in the European Union's policy agenda ten years after the Copenhagen accession criteria were defined and when all accession negotiations were concluded (Potůček, 2008).

Pension reforms in individual countries

What happened with pension systems? Unlike the European Union, the World Bank strongly advised and technically assisted the Central and Eastern European governments in introducing pension reforms. This assistance was sometimes supported by loans from International Monetary Fund to help ease the burden of indebted public budgets namely in the first decade after 1989. The core of recommendation included the advise

a) to establish mandatory privately funded individual investment co-insurance pension funds, and
b) to scale down public, pay-as-you-go pensions pillars by outsourcing part of compulsory contributions to those funds.

They were successful in most countries of the region, as national political elites were both enamoured by neoliberal discourse and politically inexperienced and naïve.

Nevertheless, a serious global economic crisis emerged in 2008, and detrimental effects on national public budgets did not wait for long (Bielawska et al., 2017; Fultz, 2012). Thus, six out of nine national governments reacted by reducing the scale of diversion from the first public to the second private pension pillar, whereas Hungary abolished its second pillar de facto completely. The following table 1 offers the overview of these changes over time.

Slovenia is the only country in the cluster of ex-communist countries which joined the EU which never experimented with the introduction of the second pension pillar. It runs a three-tier pension system with the first pillar mandatory PAYG scheme. The second pillar consists of occupational pensions that are mandatory for certain sectors and voluntary for others, complemented by the third pension pillar based on individual contracts between insurers and insured. A similar concept of pension reform was prepared by the Czech Ministry of Finance in the first half of the 1990s, but the then-Prime Minister Václav Klaus as a strong supporter of neoliberal ideas refused this alternative and enforced only the third voluntary pension pillar based on individual contracting in 1995. The Slovenian pension system has been very similar to its Western European counterparts.

Taking Slovenia aside and in contrast to most other post-communist countries, the Czech Republic did not enact it in the law until 2011 under a right-wing coalition, though only in its weaker, voluntary version. It operated for only three years, from 2013 to 2015.

Was the global financial crisis the only factor which generated freezing or even reversal of the reform run for pension privatisation in the region? Orenstein postulated the hypothesis that it could not provide a complete explanation (Orenstein, 2013). He called attention to ideational determinants such as changes in a transnational pension policy discourse, generating the new pension paradigm — initiated, once again, by the World Bank itself. Orszag and Stiglitz argued that the pension privatisation campaign was based on the '10 myths' and brought about serious long term negative unintended consequences (Orszag & Stiglitz, 2001). This book was accompanied and followed by a series of other critical reflections of the genuine concept of pension reforms embodied in the original World Bank recommendations (World Bank, 1994), namely because they pursued *(…) reform in countries that lacked necessary preconditions and failing to address issues of pension system coverage and adequacy* (Kay and Tapen, 2008, pp. 6–7, as quoted in Orenstein, 2013).

Table 1. The establishment and retrenchment of second, privately funded pension pillars in cee countries

Country	Year of establish-ment	Initial percentage of channelling out of the public pension systems	Further developments
Hungary	1998–2011	6%	8% (2010) Confiscatory penalties on those who did not switch back to the public PAYG scheme (January 2011). Participation dropped just to 60 thousand participants in 2018.
Poland	1999	7.3%	Reduced to 2.3% (May 2011), increased to 2.92% (February 2014). Further retrenchment planned in 2019.
Latvia	2001	8%	Reduced to 2% (May 2009), increased to 4% (2013), to 6% (2016)
Croatia	2002	5%	No changes.
Estonia	2002	6%	Suspended to 0% between June 2009 and December 2010, re-established to 3% (2011), 4% employer + 2% employee since 2012, 8% (2014–2017), 6% (2018)
Bulgaria	2002	2%	5%
Lithuania	2004	5.5%	Reduced to 2% (July 2009), further reduced to 1.5% (January 2012), increased to 2.5% (2013), to 3% (January 2014), additional contribution at 2% (2016–2019)
Slovakia	2005	9%	Tapped to 4% (2013), since 2017 increase by 0.25% up to 6% in 2024
Romania	2008	6%	Reduced to 2%, (2011), periodical increase, 3.75% in 2018

Source: Bielawska et al., 2017; Fultz & Hirose, 2019; Orenstein, 2013; author's update.

Short life of the second pension pillar: the Czech case[3]

In the Czech Republic, the adoption of the law introducing the second pension pillar was preceded by a serious political conflict between supporters and opponents of this step (both among different political actors and experts). Disputes about pension reform could be a good example of the public-policy process in which opposite forces govern (and arm) opinions of different camps — advocacy coalitions. The key attributes of the external struggle are, according to the Advocacy Coalition Framework (Birkland, 2005; Sabatier & Weible, 2007), the differences of viewpoints (ideationally conditioned) of individual participants. Behind them, however, we can sense a number of diverse interests. It is not surprising that this ideologically polarized issue has created over time a coalition of stakeholders from different spheres, brought together by a common vision for this particular reform strategy. With a large degree of simplification, coalitions can be defined through the optics of right-left political ideologies, connected to and emphasizing their values as reflected in pension policy. On the right side of the political spectrum, the values which resonate are the ones associated with the emphasis on the individual responsibility and regulatory role of the market, which corresponds with strengthening the degree of equivalence in the pension system (the more you contribute now, the more you will get back later on) and the increasing role of commercial entities in insuring seniors. The left side of the political spectrum stresses the value of solidarity in the pension field, pursued by the first pillar of the pension system and associated with indispensable role of public authorities and institutions. If this ideological and political battle over such an important long-term cyclical system, as the pension system for sure is, does not result in a political compromise, the likelihood that the adopted solution will not be sustainable will increase. Exactly this happened in the case of the second pillar of the Czech pension system.

The formation of the advocacy coalition, supporting the introduction of the second pillar in the Czech pension system, started with attempts to convince experts as well as the general public of the fiscal unsustainability of the public, defined-benefit, pay-as-you-go pension system due to the low birth rates, low retirement age, and increasing life expectancy. This topic has been present in the public discussions since 1995.

Elections to the Chamber of Deputies in 2010 resulted in the formation of a new right-wing coalition government, composed of the Civic Democratic Party (ODS), TOP 09 and Public Affairs (VV). This coalition brought together parties that consistently suggested a fundamental pension reform in their election programs, including the establishment of the privately funded second pillar, albeit with differences in individual concepts. The experts of the governmental advisory body titled National Economic Council (NERV) were invited to contribute to the preparation of key government pension reforms.

The government proposal included voluntary opt-out of 3% from the 28% rate levied on pension insurance premiums to the first pay-as-you-go public pillar, plus a mandatory individual additional 2% contribution. It presumed the selection of entitlements in the

[3] This section comprises the condensed history of the Czech second pension pillar. For more extensive analysis refer to Potůček & Rudolfová, 2016; Potůček et al., 2017.

form of a life annuity, a life annuity with survivor's pension for three years, or a 20 years' allowance.

The voluntary nature of the second pillar as proposed by the government would eventually cause profound disagreements between the government and representatives of NERV on what can be accepted as a compromise solution and what already threatens the potential success of pension reforms. Members of this advisory body (mainly economists) believed in the necessity to install the second pillar for the younger strata of the economically active population as mandatory.

Although the final decision in the coalition of actors ended in disagreements, the entire preparation process of the reform concept linked the same opinions of actors from different areas into a relatively "compact" unit.

The advocacy coalition on the left side of the political spectrum cemented the opposite opinion. Its members did not believe in the necessity of introducing the second pillar for addressing the issue of pension security. A key actor in the coalition was the Czech Social Democratic Party (ČSSD). Its programmatic document contained an explicit rejection of the creation of an additional fully-funded pillar within the pension system. A traditional ally of the Social Democrats are the unions, represented mainly by the Czech-Moravian Confederation of Trade Unions (ČMKOS). Regarding a pension policy, trade unions are a relatively strong actor in the Czech Republic. It is not surprising that even the pension policy has demonstrated that these partners encountered jointly shared beliefs. In the discussions on pension reform, they protested against the introduction of the second pillar and criticized the government for its reluctance to discuss alternative proposals. The centre-left spectrum was logically complemented by the Communist Party (KSČM), which consistently insisted on only parametric adjustments of the PAYG public pillar and opposed the second pillar in the Czech pension system. One of the other important actors was the civic association CESTA — the Centre for Social-Market Economy and Open Democracy. To the participants of this coalition, strengthening the equivalence of the system mediated by the second pillar meant that the solidarity provided by the public system would be weakened. At the same time, they feared the weakening of the revenue side of the first public PAYG pillar of the pension system without adequate reductions on the expenditure side.

The Chamber of Deputies of the Czech Parliament supported the governmental proposal. 109 out of 179 deputies present voted for (ODS, TOP 09, VV, 1 independent member), 70 deputies were against (ČSSD, KSČM, 2 independent members). Thus, Act No. 426/2011 introducing the second pillar into the Czech pension system was approved. It became law on 24 November, 2011 and came into force on 1 January, 2013. The voting corresponded with the composition of the two advocacy coalitions mentioned above.

New extraordinary elections to the Chamber of Deputies happened at the end of 2013. What came to the forefront of the pre-election debate was the measure to abolish the newly passed element of the pension system by all members of the advocacy coalition opposing the governmental decision. During the election, the platforms of ČSSD and KSČM explicitly expressed that, in case of electoral victory, they would seek its abolishment. Argumentative strategies were governed by the defence of solidarity as a key element in the compulsory public pension insurance, which this newly introduced element of the system weakened, and the effort to maintain the sustainability of the first pillar of the pension system.

The parliamentary elections in 2013 were won by the centre-left Social Democrats (ČSSD) and they formed coalitions, which opened up opportunities to promote the objectives of the opinions of the close partners united in opposition to the introduction of the second pillar. In the coalition agreement (ČSSD, a new political movement ANO 2011, and a Christian-democratic party KDU-ČSL) and subsequently in the government's program declaration, there occurred the explicit intention to annul the Czech second pension pillar. KDU-ČSL became a new ally, joined the government's criticism of the second pillar of the pension system, which it deemed incapable of reform, and stood for its abolition. One surprising ally was a new entity, the political movement ANO 2011. They did not dispute the existence of the second pillar in their election program; on the contrary, their aim was strengthening its robustness. In the end, ANO 2011, however, agreed with the government's policy statement, in which the coalition partners' commitment to the abolition of the second-pillar pension account remained.

On 23 October 2015, the Czech parliament passed Act No. 376/2015 Coll., which abolished the second pension pillar and Act No. 377/2015 Coll., which increased the state financial support for the third pillar (voluntary pension insurance/savings with state contribution, established in 1995) as of the beginning of 2016.

The Czech case and Hungarian experience provide two transparent examples of the relevance of domestic political and administrative power structures influencing the path of pension reforms (Armeanu, 2010), in both countries ending by cancellation of the second pension pillar. Political parties as mediators of open discontent with the ongoing privatisation reforms were able to reverse them after gaining sufficient political supremacy. The FIDESZ party in Hungary initially by freezing planned individual contributions in 1998 and by their complete cancellation and transfer to the state in 2010, ČSSD with its allies in the Czech Republic in 2013.

Recent and actual role of the European Union

The imbalance in European integration caused by the underdeveloped social pillar was identified by some politicians as well as scholars even before the outbreak of the global crisis in the late 2000s. Not only was the European Union unable to prevent its negative impact but it kept deepening the crisis through some of its fiscal measures and recommendations. By and large, the European Union did not speak to its members in a single voice. One of its two Janus faces speaks about social justice, social rights, fight against poverty and social exclusion, whereas the EU's other Janus face speaks about further trade liberalization, flexible labour market, fiscal discipline, the need to make the European economy the most competitive in the world.

The last EU recommendation document focusing explicitly on pensions (European Commission, 2012) just notes that the share of PAYG public pension systems in securing pensioners' income is declining while, at the same time, the importance of private supplementary schemes is increasing. It envisaged the future tasks of decision makers in implementing the rise of retirement age, introducing minimum pensions and making specific provisions for people in specific personal, family and employment situations.

The acceptance of the European Pillar on Social Rights (European Commission, 2017) will have, once again, only a limited, symbolic meaning. These and other political initiatives can only become materialized provided the necessary legislative changes are passed (in order to remove the constitutional imbalance between European economic and social policies) and consistent strategies and policies will be designed and implemented at the European as well as national level. This, however, would depend on the enhanced redistribution at the European level, preferably aiming at targeting individual citizens in need directly (Potůček, 2014). Nevertheless, this idea is for the foreseeable future, due to the lack of political will of national representations, politically impassable.

The unique political, social and economic experiment of European integration will continue. In the situation where neither the EU proponents nor its opponents doubt that its political legitimacy is at stake. People who see the essential historic role of European integration and its benefits are beating their brains trying to avert this negative trend. Such an exercise cannot be solved without a substantial expansion of the European Union's social competences. If the EU citizens will not have good reasons to believe that the Union can help them in life's difficulties just like they are helped (sometimes in a better way, sometimes in a worse) by national welfare systems, then the political project of European integration will lose the necessary minimum of public support and in turn political legitimacy. Pension systems have been, are and will be clear and unmistakable parts of this continuing puzzle.

Conclusion

It is the right time to evaluate the first fruits of partial privatisation of pension systems in Central and Eastern Europe. They were comprehensively summarized in a recent review article:

> *Second pillar policies remain unsettled. In some countries, further retrenchments are being planned or debated; in others, laws specifying the benefit package are blocked or repealed; and in still others, workers are being allowed to exit the second pillar and receive full public pensions. These exit options enable workers to avoid second-pillar disadvantages, yet they also strain public pension finance. To protect account holders without destabilizing public pension systems, CEE governments should consider moving to supplemental pension systems in which worker participation is encouraged but not required and which are funded independently of the public pension system, i.e. by additional contributions from workers and/or employers, as well as possible state support* (Fultz & Hirose, 2019).

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List of abbreviations

ANO 2011	Yes, it will be better (political movement, Czech Republic)
CEE	Central and Eastern Europe/an
CESTA	Centre for Socio-Market Economy and Open Democracy, Czech Republic
ČMKOS	Czech-Moravian Confederation of Trade Unions
ČSSD	Czech Social Democratic Party
EU	European Union
FIDESZ	Hungarian Civic Alliance (political party, Hungary)
KDU-ČSL	Christian and Democratic Union — Czechoslovak People's Party
KSČM	Communist Party of Bohemia and Moravia
NERV	National Economic Council, Czech Republic
ODS	Civic Democratic Party (political party, Czech Republic)
PAYG	Pay-as-you-go (pension pillar)
TOP 09	Tradition. Responsibility. Prosperity (political party, Czech Republic)
VV	Public Affairs (political party, Czech Republic)