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The sustainability of pension reforms in central, eastern and south-eastern Europe

Abstract
The World Bank has supported the fundamental reform of unfair and wasteful Pay-As-You-Go (PAYG) systems around the world since 1994. It sponsors a systemic overhaul that involves the dual paradigmatic shift from collective to individual responsibility and from state to private provision. Central, eastern and south-eastern Europe very eagerly embraced the new old-age pension paradigm without, however, knowing what its future implications would be. Widespread criticism, as well as political and economic failures, elicited a re-thinking of the Bank’s blueprint. This sounds not only as a mea culpa but it also signals that the new paradigm is a sometimes unnecessary and risky strategy which may fail to protect against old-age poverty as well as being politically very vulnerable. To substantiate this, the article accounts for the pension crises and responses in Croatia, Hungary and Slovenia. The three countries ended up with radically different institutional designs of their reformed pension systems, only to be all, to a varying degree, politically, socially or fiscally unsustainable.

Keywords: Croatia, Hungary, individual responsibility, multi-pillar systems, pension reforms, prefunding, Slovenia, World Bank

Introduction
The World Bank has supported a systemic overhaul of existing PAYG systems, which had fiscally spun out of control, while failing to protect the old, ever since its 1994 publication Averting the Old-Age Crisis.

Post-socialist countries’ retirement schemes experienced a similar fate. The transformational recession forced these countries to improvise a social safety net, which was, as a result, stretched to the point of breakdown. Hence, central, eastern and south-eastern Europe followed the Latin American example and very eagerly embraced the new pension paradigm.

The fiscal prospects of public pension schemes improved dramatically at the expense, however, of intra- and inter-generational redistribution. Creeping discrimination between cohorts and the tangible possibility of having two nations in retirement – that is, a privileged minority with standard employment relationships and a vast underclass of elderly poor – elicited yet another shift in pensions methodology, theory and politics.

Methodologically, social security experts started to regard old-age pension reforms as inseparable from labour and financial market adjustments. Theoretically, the same international organisations that orchestrated the experiment, above all the World Bank, now question their own reform blueprint and argue for greater redistribution. Politically, many governments have pre-emptively reinstated some of the foregone privileges, thereby violating a fundamental requirement for the success of both state-
and privately-run pension schemes; that is, continuing political support at all levels (Barr, 2002: 23). The prospects for the second wave of retirement innovation are, hence, turning increasingly grim.

In the light of recent developments, this article maintains that a politically sustainable pension reform has to be the result of inclusive consultation, leading to the renegotiation of the underlying social contract. This is a necessary precondition to achieve simultaneously a middle way between fiscal viability and the social equity of reform outcomes.

To this end, the article analyses the reforms in three central, eastern and south-east European countries: Croatia, Hungary and Slovenia. The ex-Yugoslav republics lie at two extremes: the latter traded benefit adequacy for fiscal viability, while the former did the opposite. Further retrenchment in Slovenia is unavoidable, as are more generous redistributive measures in Croatia. Hungary holds a middle position between the two. However, the country represents a warning for prospective reformers: insufficient consensus during legislation may very soon lead to policy reversals.

The article is divided into three sections. The first traces the developments in global pensions thinking. In the second, the crises and reforms of socialist pensions systems are outlined. The demographic, financial and labour market characteristics of the three case studies are presented in the third part, as well as the respective reform outcomes. The design of the new arrangements is analysed, as well as their social impact. Drawing on the latest available forecasts, it is argued that much remains to be done to render these systems politically, socially and fiscally sustainable.

The path to the new pension orthodoxy

During the 1944 Declaration of Philadelphia, the International Labour Office (ILO) called for a unified, national pensions scheme under a central social security administration providing old age and disability pensions (Orenstein, 2003: 175-177). This triggered a phase of pensions system diffusion that generated a number of competing retirement models. The Bismarckian and Beveridgean variants are worth emphasising.

The former is characterised by a generous income-related defined benefit system, whose main objective is consumption smoothing over the life-cycle. Coverage is limited to those in an employment relationship and the others are often only covered by social assistance schemes. The latter is, in contrast, chiefly aimed at poverty alleviation, thereby providing tax-financed, flat-rate benefits. As a result, Beveridgean schemes are often called universal, because eligibility is based on means testing or residence.

Both variants employ the PAYG method of financing, which is based on an intergenerational contract between current and future workers, as opposed to advance funding. Despite being relatively easy to set up, PAYG pensions are very vulnerable to demographic assumptions. Moreover, if they are based on defined benefit formulae, the provider (the government) bears all the risk (Thompson, 1998). Hence, these schemes are advantageous to the first generation adopting them. Subsequently, they experience harsh fiscal problems if the System Dependency Ratio (SDR), i.e. the ratio between contributors and pensioners, starts to increase without being offset by labour productivity hikes and greater contribution compliance (Brooks and Weaver, 2006: 350).

The result is that contributions are not sufficient to finance expenditures. In order to prevent a gradual collapse of PAYG schemes, there are several options which may be tried out:
The sustainability of pension reforms in central, eastern and south-eastern Europe

- retrenchment of benefits or eligibility restriction
- refinancing via higher contribution rates or tax-financed budget transfers
- restructuring by, for example, changing the mode of financing
- or a mix of the three (Weaver, 2004: 64).

The multi-pillar retirement schemes recommended by the World Bank fall under the latter category and they combine both Beveridgean and Bismarckian elements. The original three-pillar design, presented in *Averting the Old-Age Crisis* (World Bank, 1994: 15), was updated in 2005 as a result of numerous criticisms and an inability to cover the least-protected population strata (for an evaluation of the Latin American reforms, see Gill, Packard and Yermo, 2004).

The blueprint now consists of a specific five-pillar structure:
1. a basic (zero) pillar to deal explicitly with the poverty objective
2. a mandated, unfunded and publicly-managed defined benefit (first) pillar
3. a mandated, funded and privately-managed defined contribution (second) pillar
4. voluntary retirement savings (the third pillar)
5. a non-financial (fourth) pillar to include the broader context of social policy, such as family support, access to health care and housing (Holzmann and Hinz, 2005).

Far from being a rigid prescription, the criteria to set up such schemes were, from the outset, rather flexible. Reforming countries were always given a range of options to choose from. The result was that they tailored the multi-pillar schemes to country-specific conditions and adopted a great variety of different policy solutions.

**End of the new paradigm?**

The main aim of the Bank’s new paradigm is to correct the distortions to life cycle savings and work decisions generated by poorly-designed public pillars. The method to obtain this comprises the elimination of privilege and other undeserved redistribution; the tightening of the contributions-benefits link to increase actuarial fairness; and the setting up of mandatory as well as voluntary privately-funded schemes to diversify risk and promote secondary goals, such as financial market development.

It gained many supporters, but the new pensions orthodoxy also attracted major opposition. The Bank’s approach appears to be particularly ill-suited to central, eastern and south-eastern Europe. Post-socialist countries combine premature, over-developed welfare states and immature, under-developed capital markets. Under these circumstances, the introduction of private pension funds is hardly desirable. The privatisation of a mature PAYG system requires additional financing to cover the contributions diverted to private pension funds. In addition, the prerequisites of private schemes are more demanding than those of public systems. Furthermore, the region lacks developed financial markets and regulatory capacity, a financially literate population and a competent public administration (Barr, 2002: 23).

On top of these deficiencies, eastern policy-makers have not clearly explained the advantages and drawbacks of the new arrangements. This created irrationally high expectations of increasing benefits, a rather frail basis on which to build political support. Hence, when the payout phases start, lower-than-expected pensions may undermine the normative legitimacy of the newly-implemented systems, thereby violating a fundamental condition for the long-term sustainability of both state and privately-managed pension schemes. Policy reversals and widespread opposition may follow as a consequence.
Reform of socialist systems and evaluation

In order to understand why central, eastern and south-east European countries have tried *en masse* structurally to overhaul their pensions, some fundamental features of inherited retirement schemes have to be spelled out.

The erosion of socialist PAYG systems started long before the transformation of central planning into a market economy. These schemes were initially sound; however, subsequent amendments rendered them obscure, financially unsound and illegitimate in the eyes of the public.

The retirement age was low (55 for women and 60 for men) and pensions were undifferentiated. Notwithstanding the flat distribution of income, employees were granted earnings-related benefits, calculated according to best- or last-years formulae. Insurance was neither universal, as it depended on the existing employment relationship (only later was coverage expanded to farmers and self-employed), nor was it egalitarian, as privileges were granted to those holding risky and unhealthy occupations (in Poland, alone, 250 different categories of workers enjoyed early retirement rights). In addition, these systems used to cross-subsidise other budget expenditure items, e.g. social assistance, and slowly started to generate increasing deficits.

If late socialism slowly wore down the schemes, the transformational recessions triggered their collapse. In the attempt to improvise a social safety net, older unemployed or redundant workers were forced to retire. Expenditures skyrocketed. At the same time, the tax administration could not cope with the multiplication of contributors, the decline in output, tax evasion and the informalisation of the economy. Revenues from contributions plummeted, thereby undermining the fiscal balance of public pensions schemes.

During transition, the political exploitation of existing pension schemes continued unabated. Marginal and disorganised losers were penalised to obtain fiscal savings and special interest groups were granted favours in exchange for electoral support. This led to the normative de-legitimation of retirement schemes as performance expectations were betrayed and mutualism severed (Brooks, 2006).

Of the three reform options, refinancing soon disappeared from the agenda due to high social contributions, in the range of 20%-30%, which hindered the international competitiveness of these countries. Subsequent retrenchment, especially the irregular indexation of retirement benefits (Cashu, 2003), was adamantly opposed and often declared as unconstitutional. The consequence was that fundamental restructuring became the only available option and spread around central, eastern and south-eastern Europe like wildfire.

Out of the thirty countries that have introduced elements of the new pensions orthodoxy by 2008, eleven ex-socialist countries have opted for a mandatory fully-funded private pillar. Kosovo (2002) closed its public scheme and replaced it with private arrangements; while Lithuania (2004) settled for parallel privatisation, where the funded pillar co-exists as an alternative to the public system. Bulgaria (2000), Croatia (2002), Estonia (2002), Hungary (1998), Latvia (2001), Macedonia (2006), Poland (1999), Romania (2008) and Slovakia (2005) have opted for a mixed system in which mandatory private arrangements complement the public pillar (cf. Müller 1999: 19). All the other countries have either rejected the new paradigm (Slovenia and the Czech Republic), or only partially introduced it (Serbia and Montenegro now apply a strict
points system), or simply have yet to embark on comprehensive reforms (Albania, the Federation of Bosnia and Herzegovina and Republika Srpska).

One decade after the first reformers in the region implemented elements of the new pensions orthodoxy, the World Bank published an assessment of nine of these systems. First and foremost, the Bank points out the importance of simultaneous reforms in labour and financial markets. The new schemes guarantee benefit adequacy only for full career workers. Hence, the promotion of longer employment and postponed retirement is crucial. In addition, returns in private schemes swing widely and, more often than not, are poor. So, regulatory and governance practice must necessarily improve (Holzmann, 2009).

The least encouraging evaluation is, however, dedicated to the future sustainability of the reforms. The Bank not only warns that financial viability cannot be achieved just through fine-tuning, but also cautions that reforms relying excessively on internal savings, e.g. on the reduction of future entitlements, may soon lose popular support (Holzmann and Guven, 2008: 39-42). These findings are entirely corroborated by my analyses of the Croatian, Hungarian and Slovenian pension crises and reforms.

Croatia, Hungary and Slovenia

Despite having undergone completely different transitions from central planning (and self-management) to a market economy and from socialism to democracy, retirement systems in the three countries faced remarkably similar problems in the early 1990s. In all of them, lower revenues from contributions were insufficient to finance rising expenditures, while both originated from a worsening system dependency ratio (SDR), i.e. the ratio between contributors and pensioners. That most strains were transition-induced is clear. Early and disability retirement were abused in order to solve the labour market crisis, which was, in Croatia, incomparably worse than in Hungary and Slovenia due to the consequences of the Yugoslav wars.

In demographic terms, these countries started their ageing processes as far back as the 1950s. Their elderly dependency ratio (EDR), i.e. the ratio between people aged 65 and above and the entire population, will thus increase due to improved life expectancy rather than to further decreases in fertility, which are not foreseeable in the future. Table 1 – Life expectancy and total fertility rate (TFR) and EDR shows that Croatia, Hungary and Slovenia will experience very large increases in, and have the highest absolute values among post-socialist countries of, the EDR between 2000 and 2025 (Chawla, Betcherman and Banerji, 2007: 65-67).

Table 1 – Life expectancy and total fertility rate (TFR) and EDR

<table>
<thead>
<tr>
<th></th>
<th>Life expectancy at birth</th>
<th>Total fertility rate</th>
<th>Elderly dependency ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Croatia</td>
<td>71.5</td>
<td>75.7</td>
<td>77.9</td>
</tr>
<tr>
<td>Hungary</td>
<td>69.5</td>
<td>72.4</td>
<td>76.2</td>
</tr>
<tr>
<td>Slovenia</td>
<td>72.4</td>
<td>76.8</td>
<td>80.0</td>
</tr>
</tbody>
</table>

If future demographic trends point to rapid and generalised ageing and to a substantial absolute decrease in these countries’ populations (due to the fertility rate being below the replacement rate), these were not the principal factors behind the respective crises in the pensions systems. In fact, a comparison between the system dependency ratio and the age dependency ratio, i.e. the ratio between people aged 65 or more and the working population aged 15-64, shows that the former dwarfs the latter in every country by a ratio of 3:1 on average (Chawla, Betcherman and Banerji, 2007: 154-155).

The transformational recessions caused the discrepancy. The production mix in state-owned enterprises was far out of line with the demands of a market economy. Hence, instead of retraining or reactivating unemployed, redundant, older and unskilled workers, these groups were pushed into old-age and disability retirement. Figure 1 – Total and older worker employment, 2000 and 2007 shows how the employment rates of older workers in Croatia, Hungary and Slovenia was, and still is, way below EU-15 levels. Increasing the retirement age in the three pensions systems, rather than any active labour market measures, explains the hike during 2000-2007.

Figure 1 – Total and older worker employment, 2000 and 2007

Source: Eurostat

Demographic pressures (marginally) and labour market difficulties (massively) induced a harsh financial crisis in the region’s public pensions systems. Table 2 – Fiscal crises usefully tracks the responses of the three countries when faced with the deteriorating balances of their retirement systems. As the SDR worsened (due to a growing number of pensioners and a simultaneous reduction in contributors), expenditures skyrocketed. These were of course not matched by sufficient contributions-based revenues. Apart from Hungary, which was already irregularly indexing pensions in the 1980s and which continued to balance lower revenues with decreasing benefits, Croatia and Slovenia first experimented with refinancing and then resorted to re-
trenchment. When the political room for manoeuvre for both measures was exhausted, in all three countries fundamental restructuring entered the agenda.

Table 2 – Fiscal crises

<table>
<thead>
<tr>
<th></th>
<th>Croatia</th>
<th>Hungary</th>
<th>Slovenia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditures</td>
<td>Collapsed in 1990-1992 to 7.7% of GDP, then almost doubled by 2001</td>
<td>Peaked in 1994 at 10.4% before falling to 7.3% by 1997</td>
<td>Increased from below 9% of GDP in 1989 to more than 14% after 1993</td>
</tr>
<tr>
<td>Revenues</td>
<td>Plunged in 1994-2001</td>
<td>Constantly decreasing</td>
<td>Matching expenditures until 1996; stable at 10.5% of GDP since 1999</td>
</tr>
<tr>
<td>Balance</td>
<td>Stable until 1994. Budget transfers increased to 5.7% by 2001</td>
<td>Deficits up to 0.5% of GDP</td>
<td>Balanced until 1996. Budget transfers reached 4.0% of GDP in 1999</td>
</tr>
<tr>
<td>Number of pensioners</td>
<td>Increased by 55%</td>
<td>Increased by 21%</td>
<td>Increased by 25.6%</td>
</tr>
<tr>
<td>Number of insured</td>
<td>Fell by almost 30%</td>
<td>Fell by almost 25%</td>
<td>Fell by almost 10%</td>
</tr>
<tr>
<td>Contribution rate</td>
<td>Rose until 1994 and declined since</td>
<td>Stable at 37.5% of gross wages</td>
<td>Grew until the cut in employer contributions in 1996</td>
</tr>
<tr>
<td>Replacement rate</td>
<td>Fell from 75% to 45% of average wages, stable since 1995</td>
<td>Real pensions decreased by 28% in 1989-1997</td>
<td>Declined from 89.2% in 1990, and stabilised at 75% of average wages</td>
</tr>
</tbody>
</table>

Croatia, Hungary and Slovenia embarked on structural reforms almost simultaneously. It was Hungarian legislation that first saw the light of day, in 1997, followed in 1998 by that of the former Yugoslav republics. A severe and prolonged recession forced Croatian policy-makers to postpone the implementation of its small funded pillar until January 2002.

Table 3 – Basic multi-pillar design

<table>
<thead>
<tr>
<th></th>
<th>Croatia</th>
<th>Hungary</th>
<th>Slovenia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero pillar</td>
<td>GMI</td>
<td>Old age allowance</td>
<td>State pension</td>
</tr>
<tr>
<td>Eligibility</td>
<td>Entire population</td>
<td>Persons above 62</td>
<td>Persons above 65</td>
</tr>
<tr>
<td>Benefit</td>
<td>% of state-defined subsistence allowance</td>
<td>Supplement to reach 80% of min old-age pension</td>
<td>33.3% of min pension assessment base</td>
</tr>
<tr>
<td>Indexation</td>
<td>ad hoc</td>
<td>Based on old-age min pension</td>
<td>Growth of min pension assessment base</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>First pillar</th>
<th>Croatia</th>
<th>Hungary</th>
<th>Slovenia</th>
</tr>
</thead>
<tbody>
<tr>
<td>PAYG-PS</td>
<td>PAYG-DB</td>
<td>PAYG-DB</td>
<td></td>
</tr>
<tr>
<td>Retirement age</td>
<td>60 women 65 men</td>
<td>62 women by 2009 62 men</td>
<td>61 women by 2023 63 men by 2009</td>
</tr>
<tr>
<td>Vesting period</td>
<td>15 years</td>
<td>15 years</td>
<td>15 years</td>
</tr>
<tr>
<td>TCR</td>
<td>20% employee</td>
<td>24.0% employer 9.5% employee</td>
<td>8.85% employer 15.5% employee</td>
</tr>
<tr>
<td>Valorisation</td>
<td>50% prices, 50% wages</td>
<td>Net wages</td>
<td>Net wages with coefficients for horizontal equity</td>
</tr>
<tr>
<td>Indexation</td>
<td>50% prices, 50% wages</td>
<td>50% prices, 50% wages</td>
<td>Net wages</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>Second pillar</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligibility</td>
<td>Mandatory below 40 Voluntary 40-50</td>
<td>Mandatory for new entrants Voluntary for others</td>
</tr>
<tr>
<td>Mandatory for all public employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PCR</td>
<td>5% employee</td>
<td>8% employee</td>
</tr>
<tr>
<td>Indexation</td>
<td>Prices</td>
<td>50% prices, 50% wages</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Third pillar</th>
<th>2002</th>
<th>1993</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement age</td>
<td>50</td>
<td>No</td>
<td>58</td>
</tr>
<tr>
<td>Vesting period</td>
<td>No</td>
<td>10 years</td>
<td>10 years</td>
</tr>
<tr>
<td>Tax treatment</td>
<td>EET</td>
<td>EEE</td>
<td>EET</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fourth pillar (healthcare)</th>
<th>PHI</th>
<th>PHI</th>
<th>PHI</th>
</tr>
</thead>
<tbody>
<tr>
<td>PCR active population</td>
<td>15% employer</td>
<td>4% employer 11% employee</td>
<td>6.56% employer 6.36% employee</td>
</tr>
<tr>
<td>PCR retirees</td>
<td>No</td>
<td>No</td>
<td>5% of pension</td>
</tr>
</tbody>
</table>

Despite a similar involvement of the World Bank in reforms in the three countries (through extensive financing, staffing and technical advice), the policy outcomes have differed dramatically, as is shown in Table 3 – Basic multi-pillar design. State-run schemes were parametrically adjusted everywhere. Croatia went the furthest, as it transformed its degressive defined benefit scheme into an actuarially strict points system. Slovenia elongated the calculation period but did not fundamentally alter the computation of pensions. Hungary linearised the benefit formula but has postponed its application until 2013.

Even greater heterogeneity characterises the private pensions arrangements in the three countries. On the one hand, Slovenia is one of the three countries in the world (alongside Venezuela and South Korea) that has deliberately rejected the mandated privatisation of pensions and opted only for voluntary solutions (Orenstein, 2008). However, in 2004 it adopted a quasi-mandatory state-run pension fund for public employees, i.e. one-quarter of the labour force. On the other hand, Hungary and Croatia have both adopted a mandatory private sector defined contribution pillar. The latter has opted for strict separation between the pension fund management company (a joint stock or limited liability company) and the fund itself (property with special status), whereas Hungary has settled for an extremely inefficient corporate governance structure which treats pension funds and management companies as non-profit mutual trusts.

Hence, the institutional structure of the three pensions systems diverges on almost every indicator. What they have in common, as is explained in the following paragraphs, is their long-term unsustainability.

Unsustainability three times
The Croatian pension reform was single-handedly introduced by the hegemonic Croatian Democratic Union (HDZ), which not only set the actual pension value (a fundamental calculation element in a points system) at an unbearably low level but also disregarded the 12 May 1998 Constitutional Court ruling which established a ‘pensioner debt’ to be repaid for insufficient indexation in the early 1990s (Guardiančić, 2007). Such policy-making rendered Croatian reform socially and politically unsustainable.

The system’s fiscal viability is guaranteed by actuarially balancing the present value of future expenditures and revenues. However, this penalises those exposed segments of society who will not build a sufficient contributions record that may guarantee income maintenance or even shield them from old-age poverty. In fact, the average net replacement rate, that is the ratio between the average pension and the average wage, had drifted below 40% by 2007 (way below the minimum recommended by the ILO). Nestić and Rašić Bakarič (2008) calculate that contributions paid on the basis of a life-time (forty years) income equal to 97% of the average wage are only sufficient to guarantee the minimum pension.

Partially in response to these developments, Croatia has, since 1999, suffered a number of populist reversals of the design of the original pensions system. Pensioner associations and the Croatian Pensioner Party (HSU) have signed electoral agreements with both left- and right-led coalition governments, which have elicited extreme political budget cycles. The associations’ main aim was to reinstate wage indexation and eliminate the discrepancies between ‘new’ pensioners (subject to the

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actuarially strict points system) and ‘old’ ones, retired according to the previous rules (Puljiz, 2007). If insufficient benefit adequacy was a rightful motive for fine-tuning the system, the result is a breaking of the link between contributions and benefits.

Hungary experienced a similar fate as its southern neighbour. The Hungarian Socialist Party (MSzP) amateurishly and unilaterally reformed the ailing pensions system, thereby imbuing it with coarse flaws and not creating the incentives for broad political support (Guardiancich, 2008; Simonovits, 2008). As soon as the Alliance of Young Democrats (Fidesz) seized power in 1998, PM Viktor Orbán’s party started to reverse the reforms. Economic populism mounted and the returning left introduced the 13th month pension to offset the mixed price and wage (Swiss model) indexation, as well as ad hoc increases and further cuts in contributions as a means of bolstering competitiveness. Only recently has it reversed this trend and enacted some minor restructuring. Notwithstanding, these measures have not compensated for the devastation generated during the past two electoral rounds.

The spate of seriously damaging amendments increased the implicit pension liabilities almost to pre-reform levels and ruined the freshly-achieved inter-generational balance of the system (Gál and Tarcali, 2008: 148-151; Orbán and Palotai, 2005: 22). The European Union (EPC, 2007: 237) estimates that total pensions-related expenditures will climb from 10.4% of GDP in 2004 to 17.3% by 2050, while revenues will only increase from 8.8% of GDP to 9.6% during the same period. This means that the budget will have to cover a deficit equal to 7.7% of GDP, definitely an unsustainable figure. Hence, it is necessary that Hungarian policy-makers once again start a round of restructuring of the retirement system so as to create sufficient incentives for future incumbents to stick to the original reform design.

Cumbersome Slovenian consensualism has prevented its policy-makers from introducing any fundamental pensions reforms. This might be socially acceptable, as Slovenian pensioners are, by and large, enjoying some of the highest replacement rates in the region, but it is fiscally unsustainable. Labour Minister Anton Rop of the Liberal Democratic Party (LDS) failed in his attempt thoroughly to reform old age and disability pensions in 1997. His greatest mistake was to try and sideline the powerful Association of Free Trade Unions in Slovenia (ZSSS), which rallied against the government and brought the legislative process to a halt (Guardiancich, 2004; Stanovnik, 2002). The most progressive elements contained in the White Paper on Pensions Reform, i.e. the transformation of the public pillar into a points system and the introduction of a mandatory funded second pillar, were therefore ditched.

The political stalemate has enabled only a partial fine-tuning of the Slovenian pension system, which was clearly insufficient to achieve long-term financial balance. According to the World Bank, Slovenia displays the worst future fiscal prospects among nine central, eastern and south-east European countries. The EPC (2007: 314-315) calculates that the old-age retirement system will generate deficits above 7% of GDP from 2020 onwards. Notwithstanding the need for further reforms, the probability that a structural overhaul will soon enter the agenda is meagre. The veto role played by the Pensioners’ Party (DeSUS) in both centre-right and centre-left governments has prevented the enacting of even simple adjustments, such as the lowering of the almost unique indexation of continuing benefits to net wages.
Conclusions
Ten years after the first central, eastern and south-eastern European countries embarked onto paradigmatic pensions reforms, it is high time to evaluate the results and draw some lessons. The World Bank’s reform blueprint, as advocated in the path-breaking publication *Averting the Old-Age Crisis*, proved much more vulnerable than thought at the outset. Political and economic failures elicited a rethinking of the strategy, which sounds like a *mea culpa*. The same institutions that orchestrated the experiment started to admit that the new pensions orthodoxy may not be a panacea for global population ageing and that it sometimes does more harm than good. In other words:

[…] attempts to design an optimal system and then insist governments adopt it, as the World Bank has done, is unhelpful at best and a distracting form of utopianism at worst. (Myles and Pierson, 2001: 329)

Post-socialist pension systems were beset by escalating costs and inefficiency, and hence represented a favourite ground to test the new pensions paradigm. The fiscal, social and political consequences of recent reforms are, however, not encouraging. To this end, the article has presented a concise account of the pensions crises and reforms in Croatia, Hungary and Slovenia. Their demographic, labour market and fiscal prospects are marked by similarity rather than by divergence. Hence, after experimenting with refinancing and retrenchment, the three countries have opted for the fundamental restructuring of their ailing pensions systems.

The article has shown that there are significant differences both in the designs of the countries’ retirement system and in their impact on future retirees. Instead, the one similarity is that none of the three systems is sustainable. The limited ability of the Croatian schemes to prevent old-age poverty, the fiscal unsustainability of the Slovenian reforms and the political budget cycles in which Hungarian policy-makers have so eagerly indulged have all played a significant role in the deformation of policy and the need once more in all three countries for a structural overhaul of the freshly-reformed multi-pillar schemes.

The main lesson that the three countries offer to prospective reformers is that a pensions system has, first and foremost, to be politically sustainable. Only inclusive consultation leading to the renegotiation of the underlying social contract allows for continuing support at all levels. Failing that, to find a middle way between the fiscal viability of reform outcomes and social equity becomes impossible.

References


