Pensions in Central and Eastern Europe: Why It Went Wrong?

1

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	Year of 2nd pillar	Type of privatization	Contributions (% of gross wages)	Compulsory Membership
Bulgaria	2002	mixed	2-5% by 2007	born in 1960 or after
Croatia	2002	mixed	5%	born in 1962 or after
Estonia	2002	mixed	6%	born in 1983 or after
Hungary	1998	mixed	initially 6%, 8% by 2004	labour market entrants
Latvia	2001	mixed	initially 2%, 10% by 2010	born after July 1 1971
Lithuania	2004	parallel	initially 2.5%, 5.5% by 2007	none (fully voluntary)
Poland	1999	mixed	7.3%	born in 1969 or after
Romania	2008	mixed	initially 2%, 6% by 2016	born in 1973 or after
Russia	2002	mixed	6%	born in 1967 or after
Slovakia	2005	mixed	8%	labour market entrants

Underestimated transition costs

- Transition costs
  - during transition government pays public pensions while workers accumulate their own funds
- Different views

	Deduction of transition costs	Counting transition costs
Support for privatization	CEE governments	World Bank
Opposition against privatization	ILO (?) IMF	EU

Adapted from Casey and Simonovits (2012)

Impact of privatization on deficit/revenues

Country	Budget balance	Transition cost	Balance if no reform	Lost revenues 2007-60
Bulgaria	0.1	-0.7	0.8	45
Estonia	2.6	-1.3	3.9	64
Latvia	-0.3	-0.8	0.5	99
Lithuania	-1.0	-0.9	-0.1	43
Hungary	-5.0	-1.2	-3.8	93
Poland	-1.9	-1.3	-0.6	167
Romania	-5.4	-0.3	-5.1	67
Slovakia	-1.9	-1.0	-0.9	106

Stability and Growth Pact (SGP)

1. Enhanced monitoring procedures
2. Sanctions through Excessive Deficit Procedures (EDPs)
3. Renegotiation and increased flexibility in 2005

- SGP and pensions
  - SGP should not encourage or discourage any particular pension system
- Reform of SGP (2005), special treatment in EDPs:
  - granting time for adaptating fiscal policy to the front-loading of deficits;
  - excluding the compensation for systemic pension reforms (assets of funds not offsetting government debt);
  - introducing a transitory period of 5 years (2005-9)
    - application of a degressive scale, if
    - deficit is close to 3% and excess reflects the costs of the reform.

Revisions needed

- Criticism
  - triggered by expiry of the transition period, soaring budget deficits;
  - 2nd pillars mature in 40-50 years, 5 years are insufficient;
  - reformers should not be penalized with regards to Maastricht.

- Demand for SGP revision
  - letter of 8 CEE countries plus Sweden
    - change the statistical treatment of private pension funds;
    - deduct fully the costs of implementing systemic pension reforms from the budget deficit in the context of the EDP;
  - refusal of interim relief (deviations from accounting rules must be limited, comparability with similar measures, statistical certainty);
  - new draft rules allowing for flexibility for virtuous countries.

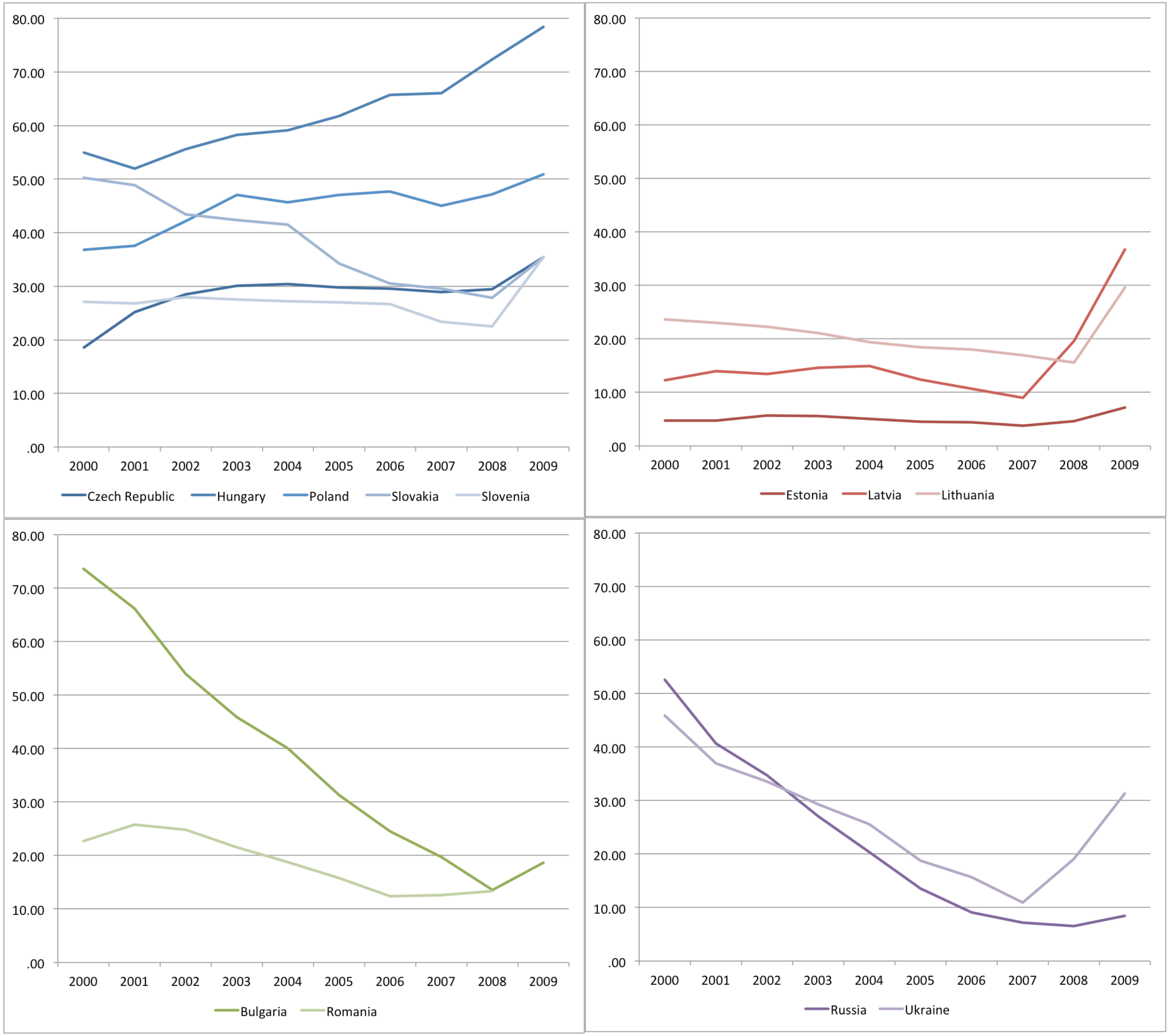
The financial crisis

- Shrinking demand
  - Most of CEE are small and open economies (<1M – 10M people).
  - Banks became illiquid in late 2008.
  - Fall in international orders triggered an economic collapse.
- Asset bubbles
  - Hungary and Baltic states had excessive exposure to foreign-denominated mortgages.

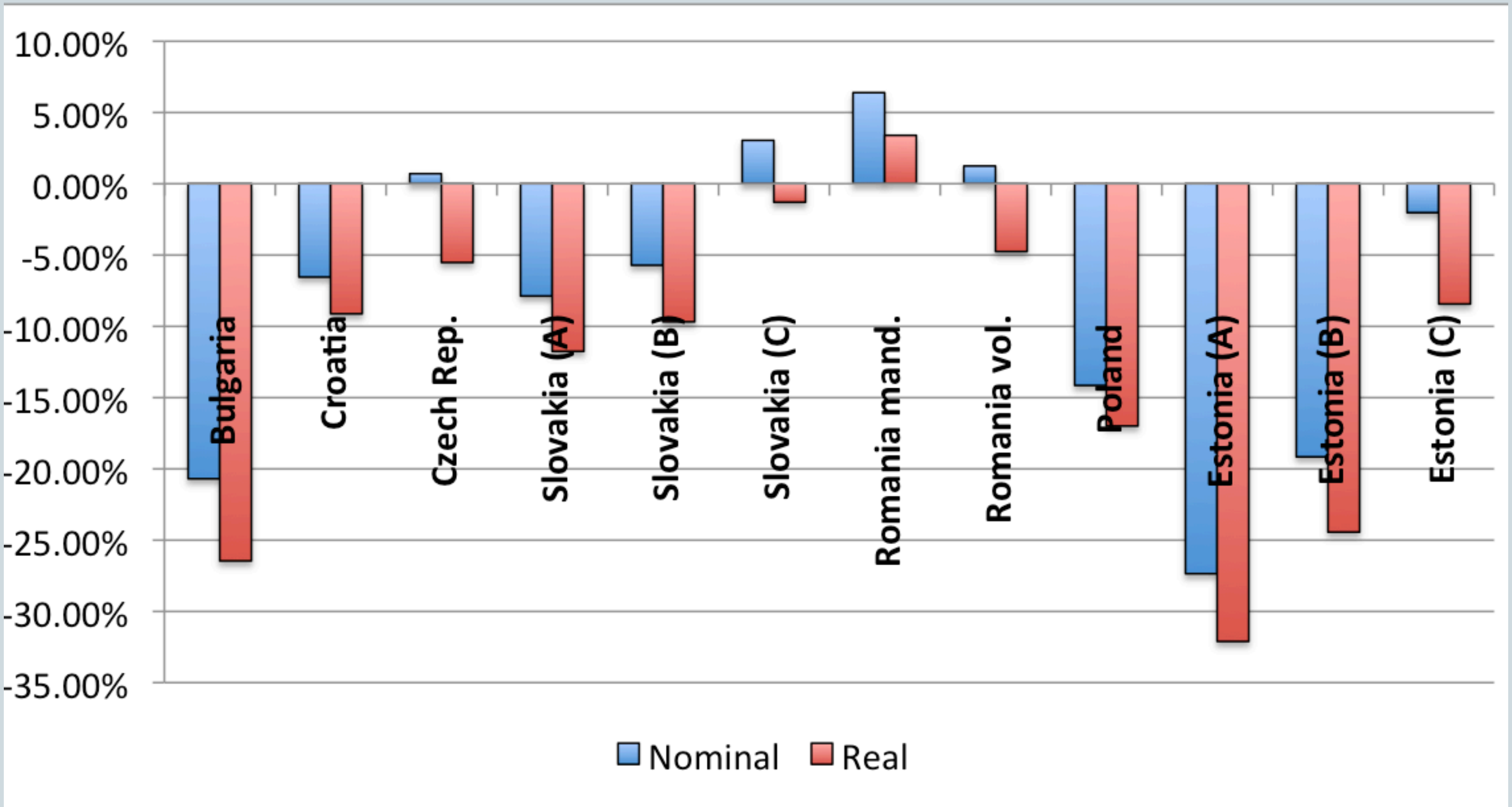
Country	BG	HR	CZ	EE	HU	LT	LV	PL	RO	SK	SI
2008	6.2	2.2	3.1	7.5	0.9	2.9	-3.3	5.1	7.3	5.9	3.6
2009	-5.5	-6.0	-4.7	-3.7	-6.8	-14.8	-17.7	1.6	-6.6	-4.9	-8.0

Mounting budget deficits

Increasing public debt



2008 RoR in CEE Pension Funds



Reforms and reversals

- Temporary measures
  - many CEE countries froze the indexation of pensions (wages of public employees, social transfers) during 2010-12
- Parametric reforms
  - various CEE countries introduced ‘overdue’ parametric reforms:
    - higher retirement age
    - fewer early retirement venues
    - lower regular indexation
- Reversal of privatization
  - governments prefer to spend for Keynesian measures than for transition costs

	Year of reversal	Reduction in contributions	Changed membership	Scope of nationalization
Bulgaria	(2014)	-	(planned voluntary)	-
Croatia	(2011)	-	(older savers may leave 2^{nd} pillar)	-
Estonia	2009	0% in 2009, gradually back to 6% in 2012	-	-
Hungary	2011	no min or max % age	very restricted	all assets
Latvia	2009	2%, increased to 4% in 2013, 6% in 2016	-	-
Lithuania	2009, 2012	2% in 2009, gradually increased after 2012	-	-
Poland	2011, 2014	2.3% in 2011; 2.92% in 2014	voluntary from 2014	Polish government bonds in 2014
Romania	(2009)	(planned increases delayed by 1 year)	-	-
Russia	2013	2%	-	-
Slovakia	2008, 2012	4% in 2012	voluntary from 2008	-

Why the Commission said nothing?

- Political reasons
  - strained relationships, in particular with Hungary
- Financing reasons
  - financing through public debt major problem
    - hence, no real saving vehicles like in the Netherlands, Denmark, Sweden etc.
- Design reasons
  - in several cases subsidiaries of Western insurance companies dominated
    - applying high management fees…
    - …despite a captive audience and no sales costs