
Pension Reform Paths in Comparison*

The Case of Central-Eastern Europe

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Abstract: Pension reform seems inevitable in Central-Eastern Europe, as the process of economic transformation has been putting great strain on the existing old-age security systems. To a great extent, local reform discourse in Central-Eastern European countries reflects the recent international pension controversy, triggered by forecasts of population ageing and a novel wave of pension reforms in Latin America. This paper analyses the different pension reform experiences of Poland and Hungary, on the one hand, and of the Czech Republic, on the other. In the comparative analysis, there is a special focus on the relationship between the relevant set of political actors, the respective structural settings and the resulting institutional choice in old-age security, shedding light upon the political economy of pension reform in the region. It turns out that neither the sole reform of public pay-as-you-go schemes nor their replacement by mandatory private fully funded systems has proved to be a suitable reform option in itself. Rather, hybrid schemes that combine elements of both systems represent a viable alternative in Central-Eastern Europe, both politically and economically.

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1. Introduction

Ageing populations and financially troubled public pension schemes, as well as a novel wave of pension reforms in Latin America have triggered renewed debate about the need to reform old-age security schemes in many parts of the world. Is it sufficient to adapt technical parameters – such as coverage, eligibility, benefit formulas and retirement age – while basically maintaining a public pay-as-you-go (PAYG) system? Or is a private, fully funded (FF) pension scheme, such as the one introduced in Chile in 1981, a more appropriate solution?

This recent international pension controversy quickly seized the countries of Central-Eastern Europe (CEE), where the process of economic transformation had put additional strain on existing pension systems. Interestingly, after years of heated pension reform debate the paradigmatic choices made in individual countries of the region are far from uniform.

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This paper deals with the pension reform experiences of Poland and Hungary on the one hand, and the Czech Republic on the other, trying to identify the factors influencing the institutional choices made in the area of old-age security. In a comparative analysis, I will focus on the relationship and interaction between the structural setting, constellations of relevant political actors and paradigmatic outcomes of pension reform in the countries considered. Inspired by the analytical framework presented by Mayntz and Scharpf [1995], which was further elaborated in Scharpf [1997], this paper is intended as a contribution to the political economy of pension reform in CEE.

First, the institutional legacy and post-socialist problem settings will be reviewed. Then, the contemporary pension controversy, clearly reflected in the local reform discourse, will be presented. Subsequently the Polish and Hungarian experience will be contrasted with the reform path in the Czech Republic. Here, the question will be raised as to what accounts for the different reform paths in the region. To explain the respective institutional choices, I will compare structural settings, actor constellations and paradigmatic choices in the three countries considered. The final section contains some concluding remarks.

2. Institutional legacy and post-socialist problem settings

Pension systems in socialist CEE, whose coverage had become near-universal in the 1960s and 1970s, showed certain basic design features. They were organised as one-pillar public systems, not separated from either the state budget or other branches of social security, giving way to different forms of cross-subsidising. Employers' contributions were the only source of financing.¹ The contribution-benefit link was weak: contributions were not registered on an individual basis, and wages in only a small number of working years were considered as relevant earnings, sometimes as little as the last year before retirement.² Although there was less pension differentiation than in any fully fledged earnings-related scheme, certain branch privileges did make a difference, and insufficient adjustment of current pensions to inflation created a situation where entry pensions were considerably higher than average pensions. Many pensioners had to go on working to make ends meet. The creation of this *de facto* extra labour supply was functional in the context of the socialist economies, where labour hoarding by enterprises resulted in an excess demand for labour on a macro level [Götting 1997: 58-60]. The retirement age was comparatively low, mostly 60 for men and 55 for women.³

Economic transformation affected the existing pension systems in CEE in a number of ways. Rising expenditures for old-age security were the result of the shift from indirect to direct transfers that were needed to halt the erosion of real pension value related to adjustment-induced inflation and to the drastic curtailment of subsidies on basic goods and services. On the other hand, the restructuring of state-owned enterprises had an impact on both the revenue and the expenditure side of public pension schemes. The privatisation, downgrading and closing-down of enterprises has been accompanied by a mounting number of disability pensions and by early retirement policies. Designed to

¹⁾ Exceptions regarding the existence of an employee's contribution include Poland from 1968 to 1972 and Hungary since 1954.

²⁾ However, in pre-1989 Hungary, length of employment and size of income determined the level of pension benefits [Götting 1995].

³⁾ Only in Poland was the legal retirement age higher – 65 for men and 60 for women.

avoid large-scale unemployment, this policy led to an increased number of pensioners and a falling number of contributors to the scheme, resulting in a continuous worsening of the system dependency ratio (SDR)⁴ of existing old-age security schemes.

According to Lodahl and Schrooten [1998: 4-5], the SDR rose from 38.9% (1989) to 60.7% (1995) in Poland, from 54.4 (1989) to 61.0% (1995) in the Czech Republic, and from 51.4% (1989) to 82.0% (1995) in Hungary, while the old-age dependency ratio (OADR) remained largely unchanged.⁵ This suggests that the current pension crisis in CEE is transformation-induced and not linked to population ageing. In the future, population ageing will affect the region, but to a lesser extent than in Western, Northern or even Southern Europe [see Prinz 1997].

It was obvious that the existing old-age security systems had to be reformed, both to restore their financial sustainability and to adapt some of the previous design features to the new economic order. It was relatively undisputed between social security experts that essential reform measures included the following: abolishing privileges, introducing employees' contributions, separating pension schemes from other social insurance plans, raising the retirement age, restricting easy access to early retirement and to invalidity pensions. Other, more controversial measures, consisted in the separation of pension schemes from the state budget and in strengthening the link between contributions and benefits.⁶

Some of the above-mentioned reform measures have already been implemented (for details, see statistical appendix). But restructuring in Poland and Hungary was not sweeping enough to restore the financial sustainability of the public pension schemes. In spite of high contribution rates – an extreme case being Poland with 36.7% of standardised gross wage⁷ –, Polish and Hungarian old-age security schemes are dependent on state subsidies. In Hungary, the state budget had to cover Pension Insurance's deficit of 0.4% of GDP in 1996. In Poland, the 1995 state subsidy to the Social Insurance Fund (ZUS) was 2.1% of GDP, while the subsidy to the Farmers' Pension Fund (KRUS) amounted to another 2.1% of GDP [Lodahl and Schrooten 1998]. In both countries, many of the necessary reform measures, such as a rise in pension age and the abolition of privileges, have met with considerable political resistance or have even been blocked by constitutional courts [Żukowski 1995: 15].

By contrast, the restructuring of the public pension scheme in the Czech Republic has contributed to a stabilisation of its financial situation; it is currently running a surplus (1996: 0.3% of GDP). It should be noted, however, that the differences regarding the financial situation of public pension schemes in Poland, Hungary and the Czech Republic

⁴⁾ The system dependency ratio (SDR) is the number of pensioners, divided by the number of contributors to the pension scheme, in the same period of time.

⁵⁾ Between 1989 and 1995, the OADR – the number of people over 60 years old, divided by the number of 20-59 year-olds – fluctuated between 28.0% and 29.8% in Poland, 32.5% and 33.8% in the Czech Republic, and 35.0% and 36.1% in Hungary [Lodahl and Schrooten 1998: 4-5].

⁶⁾ The World Bank recommends exactly the opposite, namely "reducing and flattening benefits" [World Bank 1994: 285], which is unsurprising in the context of the overall pension strategy of this international organisation. See below.

⁷⁾ The nominal contribution Polish employers are obliged to pay amounts to 45% of gross wage. However, for international comparison, the contribution has to be recalculated to account for the fact that there is no employee's contribution.

cannot be explained by the respective extent of pension reform alone.⁸ Rather, it should be taken into consideration that the Czech pension insurance also benefited from a more favourable situation on the local labour market; whereas Poland and Hungary faced a far more drastic decline in the number of contributors to the public pension scheme. Between 1989 and 1996, the number of employed Poles and Hungarians dropped by 16% and 25% respectively. In contrast, the number of employed Czechs fell by only 5% in the same period.⁹

Another reform measure, in fact the first move towards pluralisation of pension provision, was far less controversial in the CEE region: in Hungary and the Czech Republic, supplementary old age security institutions – private FF pension funds on a voluntary basis – were created in 1994. In September 1997, 1.3 million Czechs, or 25% of the labour force had joined one of 38 private pension funds.¹⁰ In Hungary there were no less than 308 pension funds, while the number of participants amounted to 0.6 million, that is, only 13% of the labour force.¹¹ Whether the much stronger response of the Czech public is only a transient phenomenon, remains to be seen. After all, a government incentive for participants was provided in both countries, a direct government subsidy in the Czech case and a tax credit in the Hungarian case [see Vittas 1996].

However, it was by no means undisputed that reforms within the public old-age security system, accompanied by the creation of private pension funds on a voluntary basis, were the right choice for CEE. Since the early 1990s, more radical proposals have been raised that demanded a complete privatisation of pension provision, thereby reflecting the credo of the 'new pension orthodoxy', to be reviewed below.

3. The contemporary pension reform controversy

For over 100 years now, economists have been divided on the features of efficient systems of old-age security, especially about the strengths and weaknesses of the two alternative financing methods [Schmähl 1995]: While pay-as-you-go (PAYG) implies that current outlays on pension benefits are paid out of current revenues from pension contributions, thus calling for inter-generational solidarity as a necessary precondition, in fully funded (FF) schemes the individual accumulates a fund over the entire working life, which is converted into an annuity upon retirement. Thus, there is a strict actuarial relationship between individual contributions and pension benefits.

Underlying the economic debate about the pros and cons of PAYG versus FF schemes are fundamental normative differences regarding the appropriate roles of the market and state in social security. This is also true for the recent international pension controversy between those who claim that it is sufficient to adapt technical parameters of

⁸⁾ For example, the Czech pension formula is still rather redistributive, combining a flat-rate component with a earnings-related component. In absence of statistical data on the lifetime working record of the insured, it is technically impossible to introduce a strict contribution-benefit link that includes past earnings records.

⁹⁾ This calculation is based on the data provided by Lodahl and Schrooten [1998: 4-5].

¹⁰⁾ Communication by Allianz-Živnobanka penzijní fond, a.s. on January 21, 1998. It should be noted that the Czech pension fund segment lacks transparency, hampering the access to basic data on the schemes.

¹¹⁾ Numbers for the Hungarian funds refer to the end of the second quarter of 1997, as communicated by the Budapest-based State Supervision of Private Funds on November 19, 1997.

public PAYG systems and the proponents of a complete or partial privatisation of old age security, generally referring to the so-called ‘Chilean model’.¹² In 1981, under the military dictatorship of General Pinochet, Chile was the first country in the world to switch from a public PAYG pension system to a multi-pillar scheme in which the lion’s share of old age security falls to private, FF pension funds.

A research report of the World Bank, published in 1994 to establish the guiding criteria of the organisation’s pension policy, served to lend international prominence to the ‘Chilean model’. With its keynote title “Averting the Old Age Crisis. Policies to Protect the Old *and* Promote Growth” the report intends to address a global problem with a universal strategy modelled not only on social policy considerations but also on macroeconomic desiderata. This report, which aroused considerable attention world-wide, laid the foundations for what appears to have become the ‘new pension orthodoxy’.¹³

The World Bank claims that the existing public pension schemes on PAYG basis “have spun out of control in middle- and high-income countries” [World Bank 1994: 1]. The only way out of the pension crisis is, according to the World Bank, a multi-pillar system modelled on the Chilean precedent. This system rests on a mandatory system of private pension funds that are intended to replace the public PAYG system as the major provider of old-age security. As benefits are actuarially tied to contributions in the private pension fund pillar, transparency increases and incentives for contribution evasion could disappear. The proponents of a mandatory funded tier expect that it increases long-term saving, capital market deepening, and growth [Ibid.: 254]. In the World Bank report, there is a special chapter on Eastern Europe. In this region, the introduction of Chilean-style pension privatisation would imply special psychological and political advantages, according to the World Bank: “These choices would signal the government’s intention to transfer responsibility to individuals for their own well-being … and establish a constituency for macroeconomic stability, financial sector reform, and enterprise privatisation” [Ibid.: 286].¹⁴

The World Bank’s most prominent opponents in the global pension reform arena are the International Labour Organisation (ILO) and the International Social Security Association (ISSA).¹⁵ In paradigmatic terms, the confrontation is between Anglo-American liberalism and the Continental European welfare state tradition.¹⁶ While the

¹²) An exhaustive study of the Chilean pension reform has been conducted by Queisser [1993]; for a more recent analysis see Mesa-Lago and Arenas de Mesa [1997].

¹³) I have been inspired by Lo Vuolo [1996: 692], who coined the Spanish term “la nueva ortodoxia en materia previsional”, to choose this label for the dominant faction within the international pension reform debate. It does not, however, apply to all national discussions, a case in point being Germany, where the ‘orthodoxy’ still defends PAYG.

¹⁴) Cf. Fougerolles, who expects that pension privatisation will reduce the conflict between capital and labour, since “individuals have a direct and visible stake in the reformed, free-market economy – they are investors” [Fougerolles 1996: 93].

¹⁵) Cf. Beattie and McGillivray [1995], representatives of ILO and ISSA, respectively, for a detailed critique of the World Bank’s pension reform concept.

¹⁶) As to the latter, I am referring mainly to what has been labelled by Esping-Andersen [1990] as “conservative-corporatist welfare-state regime”. The increasing heterogenisation of West European welfare policy makes it increasingly difficult to identify ‘the’ common continental European paradigm.

underlying normative assumption of the World Bank's "Averting the Old Age Crisis" is that private, funded schemes are inherently superior to public, PAYG pension systems, ILO representatives have tried to refute this assessment: in their opinion, many of the existing public PAYG systems continue to function efficiently, without being at the brink of collapse, and, once reformed, will be able to face the demographic challenge [see Cichon 1995]. The transition from a public, PAYG system to a private, funded pillar is neither desirable nor necessary, according to the critics of the 'new orthodoxy'. Rather, it boils down to a very risky strategy for future pensioners [Beattie and McGillivray 1995]: Since the amount of future old-age benefits is linked to rates of return on pension assets, the investment risk has to be borne by the insured.¹⁷ In many parts of the world, high inflation rates threaten to erode accumulated pension capital in real terms, and the supply of profitable, not overly risky investment opportunities on incipient financial markets might be limited.¹⁸ Moreover, the switch from PAYG to FF financing implies high transition costs: pension entitlements acquired under the former PAYG system will have to be recognised, in order to obtain political support for the switch to FF. Consequently, a double burden is placed on the transitional generations that have to contribute to their own retirement plans, while also paying for current pension obligations [Gonzalez 1996].

4. Systemic pension reform in Poland and Hungary

Reflecting the international pension controversy, in both Poland and Hungary a long-standing, polarised debate about the design of a comprehensive reform of the existing old-age security schemes was to be observed.¹⁹ Two major conflicting parties were to be identified: on the one side, following the traditional continental European pension paradigm, pension administrations, welfare ministries²⁰ and many social security experts,²¹ held that a reform of the existing public PAYG systems would suffice. On the other side, the respective ministries of finance argued that a fundamental regime change was inevitable, referring to the 'Chilean model' as a case in point. This position was initially also supported by the World Bank, which – in the Polish and Hungarian context of high external debt – was able to perform as a major external actor in pension reform.

In both Poland and Hungary, the basic conflict between the Ministry of Finance and the Welfare Ministry about pension reform was settled in 1996, when a compromise was worked out that reflects the relative weakness of the latter portfolio. The Hungarian pension reform laws were passed by Parliament in July 1997 and came into force on January 1, 1998 [see *Acts No. LXXX, LXXXI, LXXXII, LXXXIII and LXXXIV of 1997*]. The Polish pension reform laws were passed by the *Sejm* in the summer of 1997 and

¹⁷⁾ A similar argument is to be found in *Worried Future Pensioner* [1995].

¹⁸⁾ It should be noted that according to the proponents of pension privatisation, accumulated pension capital should be invested on the local financial market, not abroad, to close the postulated 'savings gap'.

¹⁹⁾ For a summary of the Polish discussion see Žukowski [1995: 28-31] and Golinowska et al. [1997: 18-21]; for the Hungarian discussion see Ferge [1997] and Simonovits [1997: 19-24].

²⁰⁾ Strictly speaking, the respective ministry is called the Welfare Ministry in Hungary and Ministry of Labour and Social Affairs in Poland.

²¹⁾ While Hungarian social security experts tend to back the continental European fraction almost unanimously, in Poland this is only true for professors of Social insurance law, while most economists dealing with social security seem to be in favour of partial or full pension privatisation.

autumn 1998, while the reform itself came into effect in early 1999.²² In both countries, the new old age system will be of a mixed type, combining a mandatory public PAYG pillar with a partially mandatory FF system. This two-tier scheme offers a purely public as well as a mixed pension option on a mandatory basis:

- 1) *The PAYG tier*, to be financed by the employer's and part of the employee's contributions, is mandatory for everybody, at least as a first pillar. The public pension scheme will cover acquired pension claims by paying some sort of compensatory pension, to be topped up by post-reform pension claims if the insured decides to stick to the purely public pension option.
- 2) *The FF tier* consists of a newly created pension fund system.²³ For young people, this tier is mandatory, complementing the first tier (mixed pension path).²⁴ Those already working are free to choose between the purely public and the mixed pension path. If they opt for the latter, private pension funds will replace part of the first tier: reformers expect that about one-third (Poland) to one-quarter (Hungary) of future pension benefits of a mixed type will come from private pension funds. In Poland, those above age 50 cannot enter the FF scheme, but have to stay in the public system (purely public pension path).²⁵

Although the general set-up of the Polish and the Hungarian pension reforms is strikingly similar,²⁶ it should be noted that both reforms differ in many details. The two most important distinctions between both reforms include the range of first-tier reforms, as well as the corporate constitution of second-tier institutions. Polish reform plans for the first, PAYG tier, yet to be passed by the *Sejm*, are much more radical²⁷ than the ones enacted in Hungary, reflecting their co-operation with a Swedish advisory team.²⁸ As regards the

²²) For the Polish reform proposal see *Office of the Government Plenipotentiary for Social Security Reform* [1997]. The reform project was supposed to come into force in 1999, but only part of the relevant legislation was passed by the Polish *Sejm* before the September 1997 elections. Still, the new coalition government has proceeded with the preparations for pension reform.

²³) The new mandatory pension funds in Hungary were set up parallel to the already existing voluntary funds. A separation of both systems is necessary, because mandatory pension funds require stricter government supervision than voluntary ones.

²⁴) While joining a pension fund will be mandatory for all new entrants to the labour market in Hungary, everybody under 30 would be required to do so according to the Polish pension reform draft.

²⁵) Note that the Hungarian reform draft provided for an age limit of 47 [cf. *Minister of Welfare and Minister of Finance* 1997]. However, in the final version of the pension reform legislation it was dropped on constitutional grounds.

²⁶) Interestingly, such pension reform projects are also envisaged in Croatia and Slovenia.

²⁷) According to [Office... 1997], early retirement and the recognition of non-contribution periods would be abolished completely. The so-called "principle of Notional Defined Capital" would be introduced into the first tier, relating retirement benefits closely to the virtual capital accumulated by the individual during working life. Benefit determination would be based exclusively on the total amount of paid contributions, divided by the average life expectancy at retirement, thereby adopting the pension formula introduced in Latvia in 1996.

²⁸) See Kruse [1997] and Persson [1998] for details on the Swedish pension reform plans, which will include flexible retirement age, benefits affected by changes in life expectancy and partial funding.

second-tier institutions in both countries, private pension funds in Poland will be created as joint stock companies, whereas Hungarian second-tier institutions are being set up as voluntary mutual benefit (VMB) funds and thus have a co-operative-like corporate constitution.²⁹

As regards underlying role models, it is obvious that the Polish and Hungarian reform concepts are not identical replications of the radical Chilean pension reform, since privatisation of old-age security is only partial. Rather, with their mixed set-up, they closely resemble its democratic version – the ‘Argentine model’, which reflected two years of political bargaining in the Argentine parliament when it came into force in 1994.³⁰ The mixed, Argentine-type approach followed by Poland and Hungary³¹ has considerable political economic advantages over the full privatisation of old-age security. Among the political compromises that facilitated the acceptance of this mixed pension reform model, the following four are most important:

- 1) The public scheme is only partially replaced by the newly created mandatory pension fund pillar, while a complete opting-out of public old age security, as in Chile, is impossible. This makes the reform approach less iconoclastic, helping to avoid the image of an overly radical regime change. It could be successful in satisfying the egalitarian (the middle-aged upwards) and the anti-egalitarian (the young) part of the CEE population at the same time, so none of these factions would strongly oppose the reform.
- 2) Employers’ contributions are maintained to finance the obligations of the public scheme, even if the respective employee chooses the FF pillar; thus, the fiscal burden resulting from the partial regime change from PAYG to FF financing is lowered. Maintaining the employers’ contribution will also please the trade unions, who perceive it as more just if the contribution burden is ‘shared’ between both parties.
- 3) There are no interest-bearing recognition bonds to the acquired pension entitlements, but a compensatory pension solution, resulting in a lower fiscal burden because no interest has to be paid. More importantly, implicit public pension debt is not made explicit right away, as in Chile, but only step by step. This could have major fiscal advantages from the point of view of policy makers, compared to full privatisation.
- 4) The mandatory pension fund pillar is being built up rather slowly: only a quarter to one-third of the future pension amount will be from pension funds, if people choose to enter it at all. The slow-track choice seems more adequate in the light of still fragile capital markets and remaining two-digit inflation in CEE, two factors that might seriously hamper the pension funds’ ability to maintain and increase the entrusted capital stock in real terms.

²⁹) It should be noted that supplementary pension funds, created from 1994 onwards in Hungary, have also been set up as VMB funds. According to political observers, the fact that the corporate constitution of the new, mandatory pension funds will also be of a VMB type is a political concession to the existing funds.

³⁰) For a comprehensive comparison between the Chilean and Argentine pension reform see Arenas de Mesa and Bertranou [1997].

³¹) This comes as no surprise, as Argentine advisors have been involved in the Hungarian and Polish pension reform process. Moreover, for first hand information, World Bank and USAID sponsored trips to Argentina and Chile for Polish social security experts, journalists and members of parliament.

However, the negotiated agreement engenders path dependence, since the mixed model might have considerable secondary effects: as contributions will increasingly be drained away from the public system, it has a built-in mechanism towards shrinking the PAYG tier, making the public scheme ever more unsustainable, fiscally as well as politically. Moreover, even when pension privatisation starts off only partially, it changes the set of relevant political actors, resulting in a strengthening of the constituency in favour of radical reform, comprising those already affiliated to one of the private pension funds as well as fund managers. This implies that from a medium-run perspective, the mixed model is biased towards a gradual phasing-in of the 'Chilean model'.³² The mixed model is, then, a useful intermediate stage from the radical reformers' point of view, rather than the ultimate paradigmatic outcome of pension reform.

5. The state of pension reform in the Czech Republic

Contrary to the Polish and Hungarian experience, there seems to have been little impact of the international pension reform controversy in the Czech Republic so far. Despite the ultra-liberal rhetoric of the former prime minister Václav Klaus ("market economy without adjectives"), the paradigmatic choice in old-age security has been well within the boundaries of the continental European welfare paradigm, at least up to now. Since 1990, the existing PAYG system underwent several reform measures, such as the abolition of branch privileges and the introduction of a separate pension contribution for employees. The most comprehensive reform package was passed in 1995 (see below).

The current system of old-age security in the Czech Republic consists of two main tiers, a public mandatory PAYG scheme that has been reformed and is still running a surplus,³³ and a voluntary private funded system, established in 1994 (see above). Concerning the current design of old-age security in the Czech Republic, the Welfare Ministry claims to have encountered a "suitable combination" [*Ministry of Labour and Social Affairs* 1996: 8] of PAYG and FF financing of pensions, trying to avoid inherent problems of both systems. By setting up a voluntary FF pillar instead of the mandatory one suggested by the World Bank, the Czech government decided to give the emerging local financial market – which is still far from well-established – a chance to cope with the influx of pension capital by lowering its amount considerably. Concerning the public PAYG system, the Welfare Ministry was well aware of the need to adapt its technical variables from time to time³⁴ and did not lack the necessary implementation power. There is a clear separation of competences: while the Welfare Ministry is directing the public scheme, the Ministry of Finance is responsible for pension funds. There does not seem to have been any major conflict of interests between both ministries so far – probably due to

³²) These considerations are in line with the World Bank's most recent recommendations for so-called "tactical sequencing" in order to achieve pension privatisation: "Allow participants to opt out of public scheme, then phase it out." [*World Bank* 1997: 145].

³³) According to Lodahl and Schrooten [1998: 15], the annual surplus of the public pension scheme in the Czech Republic was 0.5% of GDP in 1993, 1.1% in 1994, 0.7% in 1995 and 0.3% in 1996.

³⁴) For some tentative calculations regarding trends in the Czech pension system from 1996 to 2020 see *Ministry of Labour and Social Affairs* [1996]. To avoid deficits in the pension system from the year 2001 on, higher contributions, an increased retirement age, tightened eligibility criteria, and/or a partial funding of the scheme have to be considered.

the fact that current surpluses in the public scheme accrue to the general budget, which is facilitated by the lack of an autonomous pension administration. In addition, the World Bank did not have much chance to influence Czech pension reform discourse, since the debt problem was considerably smaller in the Czech Republic than in Poland or Hungary.³⁵

That does not mean, however, that Czech society is unanimous about the design of old-age security. Heated debates preceded the major pension reform package of recent times, that is, the Pension Insurance Act. Strongest opposition was expressed by trade unions: apart from a symbolic strike in December 1994, the Czech-Moravian Chamber of Trade Unions (ČMKOS) organised a huge anti-government rally in March 1995 – with almost 100,000 participants the biggest since 1989 – to protest against the raising of the pension age and to demand a separation of pension insurance from the state budget.³⁶ However, the government draft was passed with some minor changes in June 1995, reflecting the strength of the former Klaus government.

Although some debate about the introduction of a mandatory pension fund pillar started in early 1997, pension privatisation such as in Chile or Argentina are not on the agenda of the Czech Welfare Ministry today.³⁷ As Turnovec [1996: 17] demonstrates on the basis of a Median Voter's Analysis, "radical changes in the present design of social welfare in the Czech Republic... [are] politically infeasible". Rather, some observers expect the public pillar to be reduced gradually, in order to increase the scope for private pension funds. This, however, might imply the risk of individual undersaving with respect to old age.

6. Structural settings, actor constellations and paradigmatic choices in comparison

It has been shown that the pension reform path followed in Hungary and Poland differs considerably from the one in the Czech Republic. While reform measures in the Czech Republic remained well within the boundaries of the continental European pension paradigm, privatisation of old age security gained considerable importance in Poland and Hungary. A look at the structural settings and actor constellations³⁸ regarding the pension reform issue might help to explain the different paradigmatic outcomes, shedding light upon the political economy of pension reform in CEE.

It is interesting to note that in both Poland and Hungary, the finance and welfare ministries initially had divergent ideas about pension reform. Traditionally, social policy is certainly no responsibility of the Ministry of Finance. But as public pension systems in

³⁵) In 1994, foreign debt amounted to 70.1% of GDP in Hungary, to 46.2% in Poland, and to 29.7% in the Czech Republic [cf. *World Bank* 1996: 221].

³⁶) For further demands of the ČMKOS campaign against the pension draft see ČMKOS [1994]. It should be noted that the Council for Economic and Social Agreement, a forum for tripartite dialogue between the employers, the trade unions, and the state, was suspended in 1994/95 for six months because of the pension reform issue.

³⁷) For some advocates of radical pension privatisation in the Czech Republic see, for example, Jelínek and Schneider [1997] and *Liberální institut* [1997].

³⁸) Only the most important political actors involved in the pension issue are included in this comparative analysis. Country-specific, more detailed analyses of the pension-related actors and their interaction have been conducted by Ferge [1997] for the case of Hungary and Golinowska [1998] for the case of Poland.

Poland and Hungary run deficits, which have to be covered by the state budget, the position of the Ministry of Finance regarding the pension issue is strengthened. It comes as no surprise that the Polish and Hungarian pension reform blueprints include a partial switch to a FF scheme, considering that the Ministry of Finance, the stronger of the portfolios, basically consists of neo-liberal economists interested in the macroeconomic advantages attributed to the switch to a funded system.

Moreover, the World Bank's paradigmatic influence has to be taken into account, facilitated by both countries' severe external debt problems. Even if it does not amount to a full replication of its radical reform agenda in CEE,³⁹ the World Bank seems to have endorsed the Hungarian pension reform. The Bank was looking for a pension reform precedent in CEE – and got it: “The passage of the Hungarian reform by Parliament has demonstrated the political and economic feasibility of this type of reform in Central Europe” [Palacios and Rocha 1997: 42].

But the pressure from this powerful external actor and its local allies in the ministries of finance is not the whole story: for years, the relatively weak post-communist governments of Poland and Hungary have experienced considerable resistance to a reform within the PAYG system. Although these reform measures might be characterised as moderate given the paradigmatic alternatives, they easily allow to identify individual losses and were thus generally perceived as a mere cutback of acquired entitlements – without anything in exchange.⁴⁰ Under the mixed reform packages, however, the difficult task of reforming the PAYG system is combined with the introduction of a mandatory private element. The latter has two major political advantages from the point of view of policy makers: It appeals to individualised, visible ownership claims⁴¹ (individual pension accounts with private pension funds), and its weaknesses and transition costs are not transparent to the average citizen. The resulting fiscal illusion thus lowers resistance to reform.

The Czech case differs markedly from the Hungarian and Polish story, exhibiting a thorough reform of the public PAYG system, which remains the only mandatory pillar of old-age security. At the same time private FF pension funds were introduced on a voluntary basis. In fact, the Czech Republic is the only country where neither the ‘Chilean model’ nor its variations have been on the political agenda so far. Here, the absence of World Bank influence enabled a critical distance of Czech policymakers to the much-advertised Latin American role models. Until the 1996 elections, the Klaus government was strong enough to overcome the existing resistance against the reform of the public PAYG scheme, thus proving that reforms *within* the existing PAYG scheme were a feasible option in the Czech Republic, without having to resort to the ‘Argentine package deal’ with its still considerable fiscal costs.

³⁹) This would have included, on the one hand, downgrading any existing public PAYG pillar to the limited goal of poverty reduction, and, on the other, entrusting the private, funded tier with the whole of the mandatory earnings-related pension business.

⁴⁰) See Holzmann [1994: 191]: “Given the starting conditions of these [transition] countries, in which any traditional reform necessarily means a cutback of ‘acquired rights’ for important segments of the population, neither a consensus nor a majority solution could be achieved so far.”

⁴¹) Graham [1996: 10] identifies the “concept of creating new stakeholders in the private system” as a political motive for introducing mandatory pension funds.

7. Concluding remarks

From the comparative analysis conducted above, it can be concluded that institutional choices made in old-age security differ according to the structural setting, constellations and interactions of relevant political actors. As to the structural setting, the financial situation of existing public PAYG schemes (deficit or surplus) makes an impact on the perceived urgency or needlessness of a radical pension reform. This might be unsurprising, as earlier research on the political economy of policy reform has shown that economic crisis can provide the impetus to get ambitious reforms started [cf. *World Bank* 1997: 150-151]. Interestingly, however, it also determines whether, apart from the Welfare Ministry, another political actor – the Ministry of Finance, inclined towards pension privatisation – enters the pension reform arena. Within the structural setting, there is yet another important factor, that is, the degree of external debt that conditions whether an important external actor gets involved, namely, the World Bank, with its policy advice modelled on the Chilean experience. It is important to note that the respective structural settings determine which actors are involved in the process of pension reform, as well as their relative strength, conditioning much of the paradigmatic outcome, the details of which are produced in the subsequent interaction process.

Even though this short review⁴² of the recent Polish, Hungarian, and Czech experiences in pension reform has stressed the differences between the pension reform paths in the countries considered, there is also one common denominator: in paradigmatic terms, neither the sole reform of public PAYG schemes nor their replacement by mandatory private FF systems has proved to be a suitable reform option in itself. Rather, hybrid schemes that combine elements of both systems – a public-private mix as well as a PAYG-FF mix – represent viable alternatives in CEE, both politically and economically. Furthermore, they amount to a considerable departure from the monolithic institutional heritage in the region.

Still, it would be premature to attempt a definitive evaluation of the paradigmatic outcomes, as the process of pension reform is still in the making in CEE. Especially the Czech case turned unpredictable after the political crisis that led to the fall of Václav Klaus. However, in the light of the hybrid institutional choices in CEE pension reform, it seems that public PAYG systems will hold out for some more time, although their role in overall old-age security is being limited decisively.

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⁴²) For an exhaustive analysis of the Czech, Polish and Hungarian pension reforms cf. Müller [1999].

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Table 1. Characteristics of public pension systems in the Czech Republic, Hungary and Poland (1996)

Characteristics	Czech Republic	Hungary	Poland
Nature	mandatory	mandatory	mandatory
Financing principle	PAYG	PAYG	PAYG
Standardised contribution rates*	23.0% of standardised gross wage	26.5% of standardised gross wage	36.7% of standardised gross wage
Standardised employee vs. employer contribution*	5.8% vs. 17.3%	5.2% vs. 21.3%	0% vs. 36.7%
Ceiling on contributions	no	yes	no
No. of qualifying years	25	20	25/20 (men/women)
Structure of pension formula	basic + earnings-related component	basic + earnings-related component	basic + earnings-related component
Relevant earnings (in years)	last 10 (1996) last 30 (2016)	all since 1988	best 7 out of last 16 (1996) best 10 out of last 20 (2000)
Retirement age today (men/women)	60/53-57	60/55	65/60
Future retirement age (men/women)	62/57-61 (2007)	62/62 (2008)	65/60
Pension reduction in case of early retirement	yes	yes	no
<i>Branch privileges</i>	<i>abolished</i>	<i>almost abolished</i>	<i>still existent</i>

* Standardised contribution rates have been calculated on the basis of net wages including 50% of the total social insurance contribution, to eliminate those differences in the calculation base that are due to a non-proportional distribution of the contribution burden between employee and employer.

Source: Own research

Table 2. Indicators of public pension systems in the Czech Republic, Hungary and Poland (1995)

Indicators	Czech Republic	Hungary	Poland*
Deficit/surplus (in % of GDP)	surplus (0.7)	deficit (-0.3)	deficit (-1.8)
Pension expenditures as % of GDP	9.1	10.6	14.6
System Dependency Ratio (pensioners as % of contributors)	61.0	82.0	60.7
Old Age Dependency Ratio (60+ as % of 20-59 year old)	32.5	35.9	29.8
Replacement rates (net old-age pensions as % of net wages)	56.6	58.0	74.5
Budgetary balance of pension insurance (in % of GDP)	0.7	-0.3	-1.8
Percentage distribution of pensioners, by type of pension			
– old age	59.2	53.8	35.2
– disability	17.6	24.3	28.6
– others	23.2	22.0	36.2

*) excluding KRUS

Source: Lodahl and Schrooten 1998; own calculations

Table 3. Private Pension Funds in the Czech Republic and Hungary (1997)

Characteristics	Czech Republic	Hungary
Existing since...	1994	1994
Type of enterprise	Joint Stock Companies	Voluntary Mutual Benefit Fund (VMB)
Financing principle	FF	FF
Nature	voluntary	voluntary
Government incentives	subsidy (40% of contribution payments, up to 120 Kč monthly)	tax credit on contribution payments (50%; up to 200,000 HUF p.a.)
Employer's contribution	yes, out of after-tax profit	yes, tax-exempt (main source of contributions)
Supervision	Ministry of Finance	special supervising agency
No. of pension funds	38	308
Total assets	150 million US\$ (1995)	180 million US\$
Real interest rate p.a.	-4.0 to 3.5	3.0 to 5.5 (1995)
Affiliates (million)	1.3	0.6
Affiliates (as % of EAP)	25	13

Sources: Vittas 1996; communications by Supervision of Private Funds (Budapest) and Allianz-Živnobanka penzijní fond, a. s. (Prague)