Pension Reforms in Central, Eastern and Southeastern Europe: From Post-Socialist Transition to the Global Financial Crisis

Igor Guardiancich


The pension system is the important part of every country’s social security. The fundamental problem of its organization lies in the answer to the question how much are we willing to pay at present for our needs and the needs of others at present and in the future. Solving this problem is complex and involves the successful resolution of a number of factors that should be taken into account, both at the individual and collective level. The individual perspective is being changed by the transition from the status of the insured person to the status of the pensioner. At the collective level, pension system regulation depends on demographic, economic, social and political determinants of the society, but also has a negative impact on some of them. Furthermore, there is a collision between the logic of long-term liabilities and the logic of changing policies which is typical for parliamentary democracies. The time dimension requires sustainability and continuity; however the political dimension very often contradicts it, because
it is subject to variable social pressure and political pacts. In the late 20th century many countries became aware of the pension system crisis. This period was marked by demographic changes (increase in life expectancy and falling birth rates), economic turmoil (globalization and liberalization of the market in which economic shocks do not recognize national boundaries), labor market flexibilization and unemployment. The then existing organization of public and private pension systems has been compromised and major reforms began, transferring responsibility from the state and employers to individuals. In the period from the 1990s to date, almost all the OECD countries have undertaken/gone through some type of reform. Recently the ISSA (The International Social Security Association) reported important changes in the BRICS countries (Brazil, the Russian Federation, India, China and South Africa). The reforms differ in terms of their extent, from parametric changes within the existing pension systems to more comprehensive, systemic reforms. In order to promote general economic liberalization, the World Bank and the International Monetary Fund supported systemic reforms of the defined benefit pay-as-you-go (PAYG) systems, directing them towards privatization and the establishment of a multi-pillar (public-private) system with defined contribution funded parts. This type of reform has been advocated mostly in Latin America and Central and Southeastern Europe, where due to the long presence of socialist regime, private pensions have not been developed, unlike in other countries of the West.

This book deals with pension reforms in Central, Eastern and Southeastern Europe. It analyzes the reform process and the related implementation of pension legislation in the period between the collapse of socialism and the financial crisis (2008-2009) in four countries: Croatia, Hungary, Poland and Slovenia. The author gives several reasons for the choice of these four countries. Firstly, at the beginning of the 1990s all the countries had analogous problems linked to old-age retirement (inefficient and inequitable public pension system, low retirement age, benefits calculated according to the best or last years, cross-subsidization, demographic changes due to low fertility rate and prolongation of
life-expectancy, all contributing to the increase of the system dependency ratio). Secondly, in the 1997-1999 period all four countries have almost simultaneously legislated fundamental reforms. Thirdly, all of them are transition economies with different political and institutional environment. Author labels them in the following way: “Croatia was until 2000 a limitedly pluralist ‘demokratura’, Hungary an unconstrained dictatorship of the majority, Poland a parliamentary democracy under the spell of ‘politico-corporatist entities’, and Slovenia a neocorporatist social-democratic state” (pp. 9-10). He assumes that these various arrangements are the key to the understanding of the feasibility and sustainability of pension reforms. In the book the author tries to answer three research questions: 1) why reform was possible and how it was carried out; 2) what its distributive consequences are; 3) whether long-term political support is guaranteed. Hence, by comparing the political economy of the policy-making process, the author seeks to pinpoint the regularities between policies’ actors and their constellations, institutional framework, decision-making strategies and reform, thus trying to assess the future suitability and sustainability of the reformed retirement policies in those countries.

The book is based on the research, analysis and findings expressed in the author’s doctoral thesis (2009), enriched with some up-to-date developments and conclusions resulting from the time of financial crisis. It is important to note that the study is based not only on the review of numerous primary and secondary sources published by international organisations, government agencies, experts, scholars, journals, but also on more than 50 interviews with policy-makers and social policy experts. The subject is divided in 8 chapters and spread over 304 pages. It is equipped with 61 tables, list of notes, references and a user-friendly index.

After the introductory part, Chapter 2 develops the research design and theoretical model. Author explains the reasons for employing the “historical institutionalist perspective” on the basis of the study research framework of political economy of pensions in “corporative-conservative” regimes developed
by David Natali and Martin Rhodes (2008). He extends the framework to the implementation phase of the reforms and to the post-socialist context. The importance of social, fiscal and political sustainability during the whole period of implementation is emphasised. Regarding post-socialist context, it is noted that countries lack programmatic alternatives to withstand the economic crisis, and that compared to western countries, there is a greater variation of the importance of trade unions in negotiations. Continuing on the assumption that “paradigmatic” (also known as systemic) reforms are politically superior to parametric reforms, despite their doubtful economic superiority, the author basis his study on four propositions. In the first proposition he assumes that as the possibilities to enact simple corrective measures (refinancing and retrenchment) shrink to non-existent, policy-makers engage in negotiated bargains which increase their room for manoeuvre vis-à-vis the pro-welfare coalition. The second proposition relates to the argument that the paradigmatic reforms seeking to introduce policy innovations, such as funded elements into a PAYG system, enjoy greater policy multidimensionality than parametric reforms. Hence, they involve credit-claiming tactics as much as blame-avoidance strategies. In the third proposition the author warns us of the fundamental trade-offs between the fiscal and social dimensions of pension reforms. Thus, an excessive emphasis on financial viability and economic competitiveness may conflict with sound social policy. Conversely, the inability to eliminate unjustified special privileges and to tighten the contribution-benefit link in public schemes may result in a disproportionate burden for the fiscal budget and for the competitiveness of the production regime. Fourth proposition assumes that inclusive policy-making, as opposed to limited bargaining, may increase both the adaptability of reforms to the changing socioeconomic circumstances and their political sustainability in time. Further on, in this chapter the author provides the reader with a good overview of the rich literature on political economy of pension systems and emphasises important changes made in the last two decades.
Chapters 3, 4, 5, and 6 are devoted to four individual country case studies. They are titled by countries and the author's highlight findings ("Croatia: authoritarian rule, systemic shifts and neoliberal policies", "Hungary: the negative effects of political budget cycles", "Poland: how to radically rewrite the social contract", "Slovenia: neocorporatist constraints and the postponement of reforms"). Each chapter sets the general framework of the country and briefly discusses its political and economic transformations, institutional structures such as government institutions, political parties, elections, interest groups, as well as the pension system history. Undertaken parametric and systemic reforms are thoroughly described, but in this review we only have space for the indication of the main contours of the reform. Croatia made a series of parametric changes and a partial privatization of the single pillar PAYG system by introducing the mandatory and voluntary funded pillars. This reform was unilaterally imposed, which made it vulnerable to the swings in political preferences. Various pacts with the pensioner party (reflecting the social pressure that became the political pressure of the biggest group of voters) resulted in numerous little reversals, especially regarding the 1st pillar, with long-term consequences that are yet to be seen. Hungary undertook similar parametric and systemic reforms, also lacking continued political support and with policy reversals after each elections. This resulted in costly and inefficient deviations which worsened the fiscal position of the country. Due to rigid EU accounting rules combined with financial crisis, Hungary actually renationalized privately managed funded schemes. Poland took the systemic reform furthest, because not only did it privatize parts of the public system by introducing privately managed funded parts, but it also introduced the 1st pillar NDC system for younger generations. It undertook the reforms in the inclusive decision-making atmosphere, thus at first having more political sustainability than in Croatia and Hungary. However, the financial crisis created huge pressure so the budgetary problems resulted in significant reduction of contributions for the mandatory funded part: from 7.3 percent to 2.3 percent (which is foreseen to be increased by 1 percentage point in 2017). Unlike the other countries, Slovenia, due to an environment characterized by extensive
checks and balances, rejected the recommendations of the World Bank. Attempts to restructure the fundamental pension system failed. Privately managed, funded pension insurance was established only as voluntary, whereas mandatory supplementary pension insurance was introduced only for public employees. The inability to introduce a sufficiently strict link between the contributions and the benefits, created a burden for the budget and would continue to do so even more in the future. In times of financial crisis one parametric reform was rejected at the referendum in 2011 leading the government to resign. It is only after the manuscript of the book was finished that Slovenia (in December 2012) managed to pass some parametric changes (e.g. raising the retirement age to 65 years, or 40 years of service) as to reduce future financial burdens to the system, which was correctly predicted by the author.

For each of those four countries, policy and political trade-offs pertaining to those reforms are being analyzed. The author pays special attention to the implementation process, public and private pillar adequacy, fiscal viability, political sustainability and the interplay between the three. Problems and future challenges are indicated. Each case study concludes with the prospects of the pension system and reforms in the wake of 2008-2009 financial crises. Regarding adequacy issue it would be useful if the analysis would sometimes also be enriched with further information on demographic trends, labor market indicators, and main features of retirees. For example, when discussing the mandatory funded 2nd pillar pensions in Croatia, that are generally perceived as very low and not sufficiently compensative for falling replacement rates in the PAYG 1st pillar, which is often stated as an argument for increasing the contribution level from 5 to 10 percent, it would be helpful if the author also mentioned the actuary reasons for low 2nd pillar pensions: savings period that is too short (only 7 years, from 2002 to 2010 and 2011 for first pensioners exiting the accumulation phase and entering the pay-out phase), low retirement age (around 55, mostly women who used the long transition period for the increase in retirement age as an early way out of labor market and unemployment) and
high life expectancy. Despite the sometimes doubtful, although very popular, political labelling of some periods and regimes, the author depicts very well and with many details the political atmosphere in which the legislation has been adopted, as well as different political pacts in the implementation phase that resulted in policy concession and reform reversals.

Chapter 7 presents the research results. The author tests the four propositions of his study indicated above and summarizes the findings of the case studies in a comparative perspective regarding legislation, implementation and sustainability of pension reforms. Trying to trace some regularity he first compares the impact of socialism and of multiple transitions on political institutional structures, as well as on the pension crisis and early responses. Secondly, he discusses the policy-making and implications of successful paradigmatic reforms and major failures. Thirdly, he evaluates the pension reform implementation in the four countries. He traces the links between the policy-making style and implementation deficiencies or successes. In order to achieve a needed degree of comparability the author employs a version of Lijphart’s composite index of democracy, which measures regimes on a majoritarian-consensual scale. The executive-parties dimension of the index is relevant for this study and the author explains that it consists of five variables that successfully combine the political and institutional characteristics relevant to pension reforms. From the results the author concludes that the executives of the four countries enjoyed varying degrees of autonomy: “The Croatian government was the least constrained with respect to partisan or corporate actors, while Slovenia had to necessarily rely on negotiations to pass controversial legislation. Hungary and Poland occupied middle ground” (p. 237). Further on he finds that “divisive strategies and limited bargaining are more likely in unconstrained environments, such as in Croatia and Hungary. Conversely, extensive checks and balances force constrained executives to resort to inclusive decision-making and encompassing negotiations, as in the case of Poland and Slovenia” (p. 241). He points out that many policy choices were not only externally constrained by economic crisis, but more frequently subordinated
to “vote and office-seeking objectives”. Regarding other actors constellations, the author describes the role of trade unions as displaying considerable variation. It is also suggested that various interest groups, such as the state bureaucratic apparatus and financial service industry, have a big influence on policy-making by virtue of their concentration, direct linkages to political power and interest in the preservation of their privileged status. Further on, regarding policy-making and early parametric reforms, the author illustrated how, when it comes to the pension system crisis, the four countries shared many common features. A growing number of pensioners resulted in sharp expenditure increases. Trials of system refinancing by higher contribution rates and changes in adjustment formula, that resulted in lowering replacement rates were insufficient. Thus social security deficit required increased budget transfers to the pension insurance system which became too burdensome. The author demonstrates how ideological beliefs and propaganda compound systemic crisis and influence the reforms chosen by policymakers. He corroborates it by the example of Hungary, where the crisis was not as severe as in other countries, but where pension system privatization entered the agenda, and compares it to Slovenia where the pension system withstood the transformational recession. The author traced and summarized in total 8 attempts of systemic reforms in the four countries (1 in Croatia, 1 in Hungary, 3 in Poland, and 3 in Slovenia), four of them only being successfully adopted, although their future sustainability is not guaranteed. Those reforms are marked by political and policy trade-offs. Finally, this chapter provides the reader with the evaluation of various aspects of pension reform’s sustainability. Here we will go through just some of his findings. The author argues that of the countries in the region, Slovenia has the worst long-term fiscal prospects for the public retirement schemes, and that Poland might incur popular backlashes due to the strictness of the NDC formula. Regarding Croatia and Hungary, he points to the inadequate policy-making that generated politically unsustainable pension systems. In addition, he stresses that in Croatia there is an unfair distribution of gains and losses between older and younger generations, whereas in Hungary
political budget cycles annulled fiscal savings (generated through the reform) and financial viability of the system is compromised.

In Chapter 8 the author provides us with the theoretical and empirical implications of his work. Not surprisingly, he states that viable pension reforms should not be treated as an event but rather as a process that must be fiscally, socially and politically sustainable. However, we all know how difficult it is to reach that balance in practice. The author himself admits that an unavoidable trade-off between fiscal viability and social adequacy (therefore also political sustainability) requires a continuous search for compromise. This brings him to the argument in favor of the inclusive, although lengthy, policy-making as opposed to divisive, limited bargaining. He argues that this inclusive decision making increases both the effectiveness of the reforms and their political sustainability over time. Conversely, where there is a greater concentration of authority in policy-making and a consequent exclusion of competing political or corporatist groups, there is a higher likelihood of future policy reversals. In the end, the author suggests two directions for future research. One is to include Eastern and Southeastern countries in the research projects on European pension reforms (which were so far mainly focused on Western countries). Such broader projects would provide a more comprehensive insight into the political economy of changing welfare states in Europe. The other is to thoroughly analyze the multiple consequences of the financial crisis on pension systems.

Guardiancich’s book is a valuable work useful primarily to scholars but also to students of political science, political economy, social policy and social law. It expands the analytical frame for studying and better understanding of the political economy of pension reforms. On the example of four countries it shows how important the continued support is at all levels (policy-making, administration and public at large) so that the pension reform could be successfully implemented. Politicians should be aware of it as well as of the fact that thoughtful fine-tuning of the system is useful, while constant frenetic changes create huge distrust and undermine the credibility and the support
for the pension system. Absence of the support at any level and any time can seriously jeopardize the whole process, thus jeopardizing also the main goals of pension systems (reduction of poverty, provision of adequate and just retirement income and consumption smoothening).

**Literature**


*Ivana Vukorepa*