Adequate Pension Systems – lies, illusions and truths

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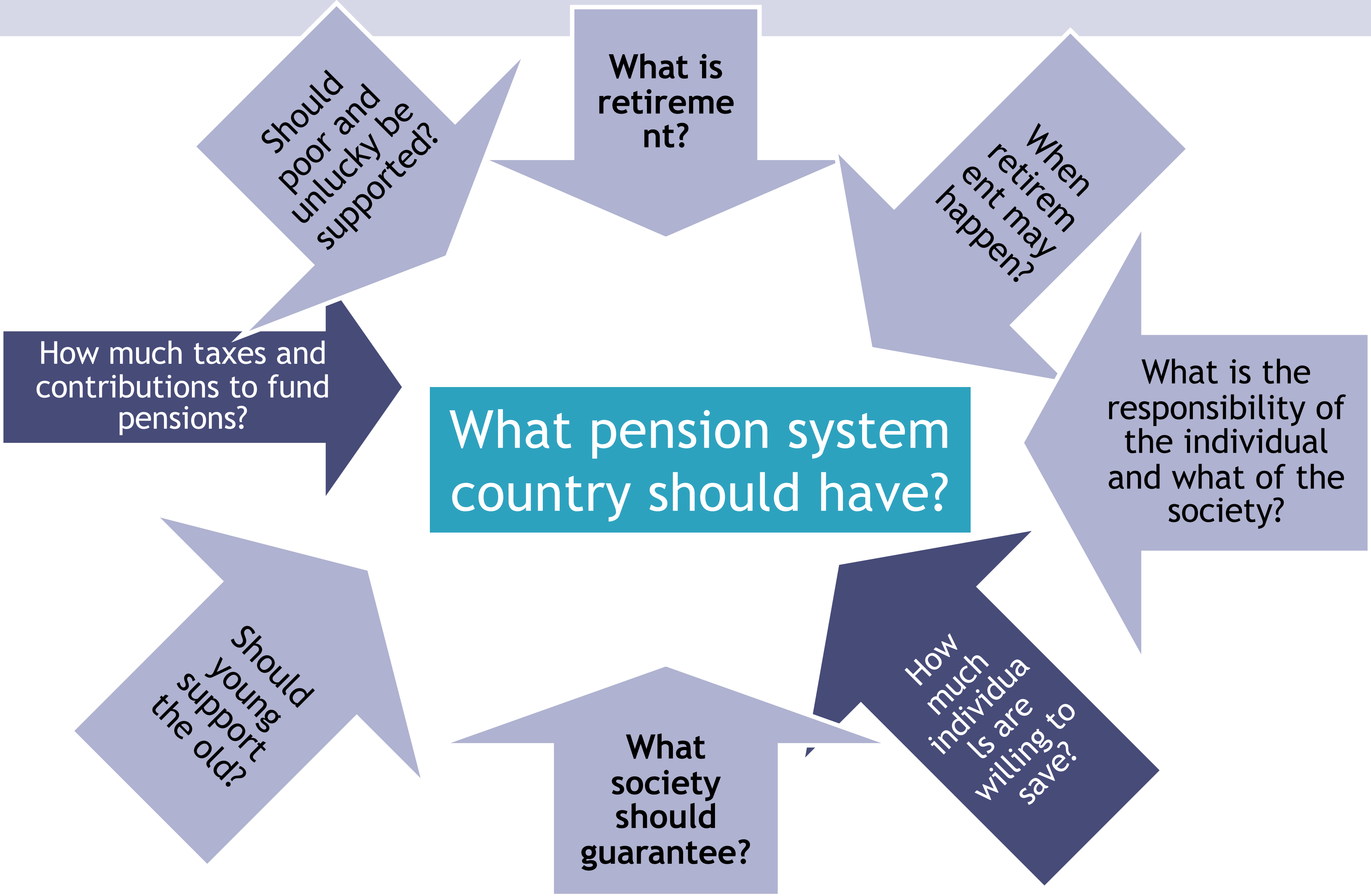
Questions to be asked and answered to agree on adequate pension system



Extent of the required implicit and explicit social contract on pension system

Definition and timing of retirement: adequate retirement age

- Happens only when person is not able to work anymore?
- Is a well deserved period of rest after working life?

Level of societal guarantees: adequate pensions levels

- Guarantee aims only at alleviating poverty for those unable to support themselves?
- Guarantees every resident a minimum income at old-age?
- Guarantees also certain proportion of pre-retirement income (replacement rates)?
- To what extent indexation follows income growth?

Degree of intergenerational solidarity and equity: adequate level of funding

- People should save for themselves
- Those unable to contribute/save should be supported
- Younger should support old generation

Social contract determines selected mix of financial and institutional solutions used by the pension system

Social contract behind pensions

- What is retirement?
- What is guaranteed by the society?
- How much solidarity to the old and redistribution towards the poorer?

Financial and institutional alternatives

- Mandatory versus voluntary
- Defined benefit versus defined contribution
- PAYG versus advanced funding
- Public versus private provision

Social preferences and national circumstances define policy objectives and priorities

Pension system has always multiple objectives

- **Preventing poverty in the old-age**
- Guaranteeing certain standard of living in the old-age/Consumption smoothing
- Intergenerational equity and fiscal and financial sustainability
- …other secondary objectives

Societies should decide which of the main objectives are priority ones

Pension system is always multi-pillar - a mix various schemes as different schemes affect/serve people differently

- Risks are shared differently
- Redistribution within and across generations is different
- People with different earnings profiles over the life-cycle may need different pension schemes

Pension system adequacy should not be in opposition to financial and fiscal sustainability

- Adequacy of benefit and financial sustainability are not separate or competing objectives of social policy. There are two sides of the same coin
- Adequate benefit promises which are not financially sustainable (that is society is not willing to pay necessary taxes and contributions) will never materialize
- Low cost pension system which is not effectively preventing poverty in the old age will not for long enjoy support in terms of willingness to finance it
- Adequacy of pension system requires social compromise between benefit levels, retirement age and levels of taxes and contributions required to finance it

Social sustainability of pensions

- **Social sustainability** encompasses all different key objectives of the pension system:
  - **Poverty prevention**
  - **Consumption smoothing**
  - **Intergenerational equity**
  - **Sustainable financing**

Pension trilemma in the demographically ageing society

- Three key interlinked dimensions of the pension system are:
  - Level of benefits
  - Pensionable age (actual retirement age)
  - Level of funding (contribution rate etc.)
- In the demographically ageing society (or ageing pension system)
  - If the level of funding and retirement age is fixed - level of benefits will be - sooner or later - automatically adjusted.
  - Fixed benefit levels (replacement rates) and retirement age will determine necessary level of funding
  - Impossible to keep fixed actual retirement age when levels of funding and benefits are fixed too

The only way to solve the trilemma is through dialogue, negotiations and compromise

- in which:
  - Level of benefits (at retirement and years after retirement) is ***adequately*** helping to achieve agreed objectives (poverty prevention plus…)
  - People are retiring at age which ***adequately*** reflects their life expectancy, health status, ability and willingness to continue working
  - Level of contribution and taxes required to finance pensions ***adequately*** reflects willingness to pay by all stakeholders

Adequacy of pension system has to be agreed national in social dialogue taking into account international standards

- Adequate pension system is defined nationally by implicit or explicit social contract which sets the design of the pension system
- There are also accepted internationally benchmarks and standards (like ILO Convention no 102 or Recommendation no 202) – social contracts which crossed the borders

Unfortunately the reality since decades is very different: pension reforms introduce automatic mechanisms to replace policy making supported by social dialogue

- Increasing contribution rates (or tax financed subsidies to pension schemes) became a political taboo – nobody supports it anymore
- Many pension schemes are reformed and converted into defined contribution:
  - Through privatizations of PAYG/DB schemes
  - Through making PAYG/DB schemes purely earnings related (so these schemes work similar like DC making benefit levels dependent on available resources – guarantee stable financing but not benefit adequacy
- Adequate benefit indexation mechanisms are abandoned and replaced by discretionary measures
- Reaching reasonable compromise on in increasing retirement ages becomes difficult as labour markets and employers exclude and discriminate older workers

Lies are spread and illusions created to facilitate privatizations and move to contribution schemes to

- *"There is a global crisis of social security"*
- *"We have old age crisis"*
- *"One cannot have trust in how public institutions manage our money – private sector does it much better"*
- "*Implicit pension debt is unsustainable*" – we even change national accounting system to show it
- *"Fully funded pensions will solve the ageing problem"*
- Etc. etc.
- ***Social dialogue on pensions was replaced by the force of lobbying by international financial services sector and by neoliberal dogma of the small state and low taxes and social contributions***

Lies and illusions need special conditions to bloom

- In ***Central and Eastern Europe***, in countries in transition from centrally planned economies to market economies there was limited trust in public institutions, including existing social security, there were many illusions with respect to how private sector works and neoliberal, ideas were flourishing and institutions of social dialogue were very weak
- Politician saw also a move to defined contribution – private or not – as a convenient and attractive way allowing to avoid pushing for retirement age increases
- That is why many partial privatizations of pension happened there, while privatization processes were very limited in ***Western Europe***
- There are exceptions: ***Czechia*** never privatized their social security pensions, due to many financial pyramids scandals at the early stage of transition. ***Slovenia*** never privatized due to a strong opposition from the trade unions.
- Practically all countries in the region partially or fully reversed pension privatizations after the financial and economic crisis at the end of the first decade of 21st century. Why? Should one be hopeful about the future?

Privatization reversals in Central and Eastern Europe happened because of fiscal concerns and not in order to improve adequacy o pension systems

- Transition costs in the range of 2% of GDP became unsupportable after the increase of deficits and debts as a result of financial and economic crisis
- In the EU member countries pressure from the European Commission to reduced that deficit and debt eventually became more important than lobbying from financial services sector
- Increased availability information about expected pension levels from the privatized pensions and about elevated administrative charges undermined earlier illusions about "retirement under palm trees" and decreased support for private pensions
- However, in some countries, the way through which privatization reversal was done undermined further trust in public institutions and government
- Governments are finding other ways to reduce benefit levels and adequacy of pensions system to keep the costs of the pension systems in balance

Automatic mechanisms will not replace good policy making in social dialogue

- Privatizations (N)DC reforms introduce automatic mechanisms to ensure long-run financial sustainability of pensions
- There are no similar mechanisms to guarantee adequacy...
- On the contrary, pension cost stabilization takes place mainly through benefit reductions and other changes potentially detrimental to adequacy (like forcing people to delay retirement even when they are not fit to work or can't find a job
- Automatism will not replace good policy making through well informed social dialogue based on agreed adequacy targets, balancing shorter and longer term needs as well as benefit adequacy with financial sustainability

Instead of conclusion: Quality policy making needed also

- What we need is not to keep politicians away from pensions and other social policies - we need to make sure that decisions taken by politicians are the right ones, balancing shorter and longer term needs as well as balancing benefit adequacy with financial sustainability.
- A key prerequisite must be to ensure through democratic and participatory mechanism the full participation of each group of stakeholders – workers, employers and governments – in establishing the relevant standards, and in creating and maintaining the permanent structures through which pension systems may be monitored, verified and adjusted in a responsible way.