REPORT ON WORLD BANK-TRADE UNION MEETING ON PENSION REFORM
21-22 May 2003, Washington

1. Introductions

Representatives of the World Bank, ICFTU/Global Unions, and WCL described the process for enhanced regular dialogue between unions and the IMF and World Bank under the auspices of which the meeting has been organized, and expressed the objectives of their organizations in taking part in the meeting.

2. Role of national pension (social security) systems

Robert Holzmann, director of the Social Protection Unit of the World Bank, presented the Bank's approach to pension reform. Since the publication of *Averting the Old Age Crisis* in 1994, the Bank has gained a great deal of experience in assisting countries in the reform of their pension systems. Among the lessons learned are that not all pillars of the Bank's multi-pillar approach need to be part of the country's system. However there should be a basic social pension funded through general government revues and some pre-funding of retirement income. The Bank recommends a mandated second-pillar personal pension plan as a benchmark, not a blueprint. The Bank is now placing considerable emphasis on the process of reform, rather than simply the reform itself, and seeks constructive discussions on the reform with all interested parties, including trade unions. The Bank encourages countries to debate their pension options but to be clear about the costs of the different options.

Bob Baldwin, senior economist with the Canadian Labour Congress, presented the concerns of the labour movement with the World Bank's approach on pension reform. Firstly, by emphasizing mandatory individual savings accounts, the approach subjects workers to great variations in their pension income replacement rates. Secondly, the approach places too much emphasis on objectives that are not central to pensions and not enough on the earnings replacement objective. Thirdly, the Bank's approach plays down the risks of failure of private pension systems while over-emphasizing the political risks of public schemes. Successful operation of privately-administered savings plans require a significant public regulatory apparatus, something that may be even more difficult to set up than a well-run public pension scheme. He invited the Bank to revisit *Averting the Old Age Crisis* in light of the experience it has gained over the past decade.

There was discussion about the role of unions in pension reform and administration. It was remarked that the involvement of the social partners in the administration of pensions can create a protection against political risks.

3. "Pay-as-you-go" (PAYG) vs. fully-funded systems: Points of contention

Elaine Fultz, senior social security specialist with the ILO, spoke of the fact that disagreements between the ILO and World Bank on pension reform may have confused constituents on a country level and that efforts should be made to clear up points of contention. Some of the questions that deserve further explanation are the effects of demographic changes, which have impacts on funded as well as PAYG systems; the advantages of risk diversification strategies; and the very high transition costs associated with switching from a fully public to a second-pillar system, costs that are in large part absorbed through decreased benefits. She noted that privatized funded schemes have a very small impact on national saving but generally have very high administrative costs. The World Bank should help countries tighten regulations to protect workers and help governments, which continue to play a central role in pension administration whatever the system chosen, do their job better.

Anita Schwarz, senior economist with the Social Protection unit of the World Bank, spoke of the impact of ageing on non-funded pension systems. Because rates of return on capital generally exceed wage growth, workers can earn higher pensions with funded systems. She noted that even in defined benefit public schemes, most governments are adopting some degree of funding, and that private fund managers perform better than public managers. She also noted that workers seem to prefer funded pensions when given the choice. While the transition towards more funding does result in higher fiscal costs, the system will gain through improved long-run capacity to deliver benefits.

Sandy MacKenzie, assistant director of the IMF's Fiscal Affairs Department, noted that the IMF is only a small player in pension reform, but does have concerns regarding their impact. The high administrative costs of privatized schemes, even in developed countries such as the UK, are one of these concerns. However increased fiscal deficits due to privatization are in part a matter of definition; if pre-funding of existing public schemes were introduced, that would also increase the deficit. The IMF agrees with previous speakers as to the need to put greater emphasis on governance of pension systems.

The discussion touched on the importance the World Bank gives to redistribution in pension systems, questioned the claim that workers always prefer funded pension systems, and commented on perceived contradictions in the Bank's message on pension reform. It was also mentioned that some of the newly funded systems are overwhelmingly invested in government bonds, such that one could suggest that they have become disguised PAYG systems.

4. Experience of pension reforms in Latin America

Chile: Hermann von Gersdorff of the World Bank and Jorge Millán of the *Central Unitaria de Trabajadores* discussed the Chilean pension system, which was almost completely privatized in 1981 without Bank assistance. Mr. Von Gersdorff noted that the reform had introduced some uniformity in the formerly complex pension system and offered high rates of return to early entrants in the new regime. Commenting that the reformed system was still young, he pointed out that commercial expenses have been high but decreasing. Total pension coverage has increased only slightly, thus remaining one of the challenges for further reforms, along with increasing investment returns and reduction of costs. Mr. Millán felt that a reform of the pension system is urgent given the fact that only 60% of the population is covered and that administrative costs are high and applied in a regressive manner. In addition to these failures, the system that is privatized in theory remains highly dependent on government subsidies and has proved to be very costly to the Chilean state, which spends 31% of its national budget for social security.

Uruguay: Ernest Murro, a labour representative to the *Banco de Previsión Social* and Anita Schwarz of the World Bank discussed the pension reform implemented in 1997 with Bank assistance. While recognizing that the former system needed substantial reform, Mr. Murro felt that the creation of a privatized second pillar has not resolved any of the problems. Pensions payouts have decreased, as has the total value of invested capital in the funds. The number of those contributing to the funds has declined, and administrative costs have been high and increasing. More than half of the funds are invested in government bonds. Ms. Schwarz noted that the former regime would have required huge increases in contributions and that the new regime has provided a fiscal improvement. However the current regime is still not viable and restrictions on investments are an obstacle to obtaining higher rates of return.

Brazil: Asta Zviniene of the World Bank and José Ricardo Sasseron of the *Associação Nacional dos Participantes de Fundos de Pensão* discussed the current state of the Brazilian pension system, where the Bank has provided assistance. Ms. Zviniene noted that Brazil spends as much on pensions as some OECD countries but covers less than a third of the population. The regime for public sector workers is particularly costly and has therefore has been singled out for reform. While the reform will free resources for other uses, it does not unify the system nor achieve full sustainability. Overall, contribution rates must decrease if coverage is to increase. Mr. Sasseron spoke about the debate on pension reform taking place presently in Brazil and noted that there is no proposal to transform the current defined benefit PAYG pension scheme. He also provided information about the role of private pension funds, which are based on voluntary participation.

Colombia: Saúl Peña of the *Sindicato de Trabajdores de la Seguridad Social* and Hermann von Gersdorff of the World Bank discussed the partial privatization that took place in 1993 and the current new reform initiative, for which the Bank is providing assistance. Mr. Peña observed that the introduction during the 1990s of private funds and individual accounts coincided with increased labour market flexibility. The new system's success depended on increases in employment and wages, which have not materialized. He noted that coverage remains low and that the transition costs of shifting to a partially privatized system has created an increasingly heavy burden on public finances. Mr. von Gersdoff agreed with the problems of low coverage and high transition costs, and submitted that high taxation rates of labour income, including pension contributions, constituted a major obstacle to increasing pension coverage. In his view, the 1993 reform was incomplete and a further reform towards a unified system was needed.

5. Experience of pension reforms in Central and Eastern Europe

Croatia: Michal Rutkowski of the World Bank and Jagoda M. Smid of the Union of Autonomous Trade Unions of Croatia discussed recent pension reforms in Croatia with

Bank assistance. Mr. Rutkowski considers the reform to have been a success, since implementation of the second pillar in 2002 went smoothly and will lead to a reduction in public expenditures. The Bank also learned from earlier experiences and encouraged tripartite discussions on the reform. However costs of the privatized system are high and the private funds, which are overwhelmingly invested in government bonds, have had little impact in developing the capital market. Ms. Smid responded that there was no real dialogue with unions on the reform. The main arguments for introducing the reform, in terms of expected positive economic effects, have not materialized, in part because of the underdeveloped capital market. On the other hand, little attention was paid to the needs of workers and retirees, who can now expect to receive reduced pensions.

Hungary: Maria Augusztinovics of the Hungarian Academy of Sciences and Roberto Rocha of the World Bank discussed the Hungarian pension reform, which received support from the Bank. Ms. Augusztinovics noted that the public PAYG scheme had achieved 100% coverage before the post-communist transition, but underwent great strains because of rising unemployment during transition. Attempts were made to restore viability by reducing pensions and increasing the retirement age. A hasty and ill-prepared decision was made to introduce a private mandatory pillar in 1997. Because of very high administrative costs, the funds have delivered negative rates of return and will result in decreased incomes for retirees. Mr. Rocha pointed out that Hungary's neighbours also had experienced rising unemployment in the transition, but had not experienced the erosion of the tax base and the loss of revenues observed in Hungary. He also stated that the Bank had made genuine efforts to reform the PAYG system, but the system was largely discredited by ad hoc reductions in benefits throughout the 1990s. The Government decided to implement a three pillar system in 1995 and the law was passed by Parliament in July 1997. The legal and regulatory framework for the new private pillar was prepared within a tight timeframe and contained several flaws that still need to be corrected. Despite these problems, Hungarians appear to have supported privatized pensions, as evidenced by the high degree of voluntary switching to the new regime.

Romania: Yvonne Sin of the World Bank and Petru Dandea of the Cartel Alfa trade union confederation discussed the current state of Romania's pension system. Ms. Sin described the partial reform that was carried out in 2001. The system continues to have serious problems due to very high contribution rates, a declining contribution base due to a shrinking and ageing population, and too many discretionary parameters. Policy actions should aim at preserving the revenue base while reducing payroll taxes, and diversifying retirement income sources while ensuring that any new funds are carefully regulated and supervised. Mr. Dandea observed that the pension system had been used as a political instrument to absorb the costs of downsizing during a poor economic situation. The demographic pressures on the system have had serious effects on pensions, but privatization could only lead to more inequality. There had to be a more coherent approach to pension reform in which the social partners would be included.

Slovenia: Tine Stanovnik of the Institute for Economic Research (Ljubljana) and Robert Palacios of the World Bank discussed pension reform in Slovenia. Mr. Stanovnik recalled that Slovenia has maintained a strong practice of social partnership on social legislation, and this influenced the three pension reforms carried out in the 1990s. The last reform of 2000 should stabilize the system for the next ten years through gradual reductions of replacement rates and increases in the retirement age in the public regime, and through favourable tax treatment of a third voluntary private pillar. However a proposed second mandatory private pillar supported by the Bank was rejected on the grounds that it would undermine intergenerational solidarity and impose high transition costs. Mr. Palacios observed that, by rejecting the introduction of a second pillar, transition deficits were avoided in favour of long-term deficits and that younger workers may eventually have to pay the cost. The system would have to be reformed again in 15 to 20 years.

6. Lessons to be learned and conclusions

Four speakers offered summary remarks on lessons learned and issues requiring further attention in pension reform. Rafael Rofman of the Latin American region of the World Bank noted that pension reforms in the region focused largely on fiscal problems and the need to promote growth. There have been gains in terms of efficiency and risk diversification and transition costs have been manageable. However, increasing employment informality and unemployment have resulted in stagnating or decreasing pension coverage. Income protection for the elderly should be defined as a right regardless of the worker's status and coverage must now move to the top of the agenda. This can be done by improving contributive schemes and by introducing zero-pillar basic social pensions. Ernesto Murro of Uruguay observed that pension reforms supported by the Bank have not achieved goals that the Bank agrees with, such as increasing coverage and contributing to poverty reduction. He noted some contradictions during the meeting in the approaches presented as overall Bank policy on pension reform and the actual reform plans supported by the Bank on a country level, as well as different standards used by the Bank to judge reforms. He quoted Latin American government officials who recently called for a major rethinking of pension privatization strategies. He suggested that a more serious involvement of social partners in pension reforms and in periodic national consultations on pension issues would contribute to correcting mistakes of the past, and invited the Bank to give more emphasis to training and information exchanges on the issue.

Hermann von Gersdorff of the World Bank observed that too heavy a load had been placed on pension systems, notably in Central and Eastern Europe, in terms of using the systems to address social problems, and also to promote savings, capital markets and economic growth. Pension systems should serve retirees first and foremost and funding could address some of the problems associated with existing systems, such as the challenges of an increasingly mobile workforce in the European Union. However funding requires that the state play an important role in supervision of pension funds. Emmanuel Reynaud, chief of the Social Security Policy Branch of the ILO, welcomed the more flexible approach and emphasis on the process of reform enunciated in the presentation on Bank pension policy, but noted that this more flexible approach was not reflected in some other Bank presentations. The Bank's track record on pension reform, focused on introducing individual accounts, has not shown much success in extending coverage or contributing to social cohesion. He agreed with Bank speakers that the key issue should be coverage and noted that the 2001 ILO conference also concluded that this should be the priority of pension reform. He announced that the ILO would, with the support of unions and employers' organizations, be launching a campaign on the theme "Coverage for all" and invited the World Bank to join.

In subsequent discussion, questions were raised about the role of unions in defending the interests of informal workers in extending pension coverage, on how IMF and World Bank economic policies may have to contributed to growing informality, on the lack of involvement of workers and their unions in recent pension reforms, and on foreign ownership of privatized pension funds in developing countries.

In concluding comments, Robert Holzmann of the World Bank expressed his opinion that the meeting had led to a better understanding on pension reform issues. He hoped that union participants could appreciate that there are differentiated views on pensions within the Bank, that the Bank had achieved some successes, and that the Bank has given greater priority to the coverage issue. He invited trade unions to get more involved in pension reforms by informing their members about reforms and pushing governments on their concerns. Unions should play a role in demanding better performance from pension systems and could also contribute to developing incentives for workers to remain longer in the workforce as the population ages. Peter Bakvis of the ICFTU/Global Unions observed that the meeting had allowed for a fruitful exchange of views between unions and the Bank on pension issues, an area where the unions have been very critical of the Bank's approach. To the extent that the Bank's approach is more flexible than it has been in the past, the Bank would do a service to unions, governments and its own staff by updating its policy documents on pension reform. There seemed to be agreement by all participants on two major issues – the need to put coverage on the top of the agenda and the importance of involvement of social partners in pension reform. The Bank could play an important role in ensuring that in-depth social dialogue on pension reform takes place at the national as well as the international level.