Pension reform in Slovakia:
the context of economic globalisation

Ivan Lesay

European Trade Union Institute
for Research, Education and Health and Safety (ETUI-REHS)

Brussels, November 2006
Abstract

This paper presents an analysis of the pension system reform in Slovakia. The context of economic globalisation is crucial in any assessment of this topic. The paper is organised in six sections. The basic features of the pension system before and after the reform are surveyed briefly in section 2. The paper describes the legislative and institutional basis of the two systems, their respective components and the ways of disbursing pensions in each system. Sections 3, 4 and 5 constitute the paper’s core. Section 3 lists the reasons for reform, categorising them in terms of stated and real reasons. As regards the former, it seeks to interpret and question the usually presented grounds, especially the unsustainability of the previous way of financing the pension system. The paper then looks at the real grounds for reform: particular attention is paid to ideological and political grounds, the influence of the international financial institutions and institutional investors’ efforts to expand the financial markets. Section 4 characterises the risks and possible social impact of reform; in particular, it analyses the risk of uncertainty, but also the problem of rates of return in the reformed system. Section 5 seeks to define criteria of public interest in relation to the pension system and also evaluates pay-as-you-go and pre-funded schemes on this basis. Section 6 briefly outlines measures that might help to protect the pension system from various threats. The final section looks at pension reforms in Central and Eastern Europe in order to present an example of welfare state retrenchment trends in the post-Communist region.


Thanks are due to Oto Sobek, Michal Polák and Sarah Huffman for their very helpful comments and discussions. The views expressed and any remaining errors are, however, solely those of the author.
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List of abbreviations
AFP – Administradoras de Fondos de Pensiones
APV – Actual Pension Value
APWP – Average Personal Wage Point
BPSF SIA – Basic Pension Security Fund of the Social Insurance Agency
CAS – Country Assistance Strategy
CEE – Central and Eastern Europe
CEPA – Center for Environmental Public Advocacy
CFC – Chlorofluorocarbon
CLSAF – Centre for Labour, Social Affairs and Family
CPI – Consumer Price Index
DB – Defined Benefit
DC – Defined Contribution
FDI – Foreign Direct Investment
FMA – Financial Market Authority
GBP – GB pounds
GDP – Gross Domestic Product
IMF – International Monetary Fund
MOLSAF – Ministry of Labour, Social Affairs and Family
NASR – News Agency of the Slovak Republic
NBS – National Bank of Slovakia
NDC – Notional Defined Contribution
OACT – Social Security Administration Actuary’s Office
OECD – Organisation for Economic Cooperation and Development
PAYG – Pay-As-You-Go
PID – Project Information Document
PMC – Pension Management Company
RDC – Research Demographic Centre
SAS – Slovak Academy of Science
SGI – Slovak Gas Industry
SIA – Social Insurance Agency
SKK – Slovak Crown
SMP – Staff Monitored Program
WB – World Bank
1. Introduction

‘Pension reform’ was declared the most frequently used term in Slovakia in 2004.¹ No wonder. The huge media campaign by the Slovak government and private pension management companies (PMCs) certainly played a significant role.² Equally important, however, was the fact that the pension system reform was probably the most substantial systemic change since 1989. The social security system is the core welfare state programme. It accounts for a huge proportion of the state budget and is marked out by its long-term scope, its inclusivity, its complexity, and so on. Furthermore, the Slovak approach to reform has been the most radical in Europe.³

These striking features of Slovak pension reform were the first, ‘domestic’ reason for the choice of this subject. The second, no less important reason was the international context. The pension reform is not an original invention of its Slovak authors, but a concept imported from abroad. A few years ago no one in Slovakia had any idea about pension reform, except for a few experts. This tiny group may have been aware of the issue as early as 1981, when the first pension system reform took place in Chile. However, the discussion on pension reform has really only come to the fore in the last decade, since the World Bank became involved. In this period, the Bank’s three-pillar model has been adopted by a number of Latin American and post-communist countries. The World Bank is one of the leading actors in economic globalisation in the area of pension systems. It would therefore be a mistake not to consider this context of pension reform. Most people in Slovakia link economic globalisation at best to broken windows at McDonalds; in the worse case they have no idea about it. This is despite the fact that globalisation has massively impacted on their everyday lives, for example in the form of neoliberal reforms of the education system (introduction of university fees, and so on), health service, tax and pension system, Labour Code, and so on. The second principal motive for writing this paper was thus to identify the close connection between economic globalisation and pension reform in Slovakia.

The intention in this paper is to question the officially stated reasoning for the need to reform the pension system in the proposed manner, to identify the real reasons for the reform and to introduce an alternative. The hypothesis is as follows: The social security system reform in the Slovak Republic was not motivated by the unsustainability of the previous way of financing the pension system, as the approved reform measures generally do not solve the indicated problems. The officially stated reasoning for the need to reform the pension system is intended to detract attention from the real reasons, thereby legitimising the reform in the eyes of the public. The real reasons are as follows: institutional investors’ efforts to expand financial markets through the inflow of previously

¹ The result of an opinion poll carried out by TNS SK with the help of the Neopublic Porter Novelli agency. The interview method was used on a sample of 1,056 people at the turn of 2004/2005. Pension reform was considered the most typical word or term characterising the past year by every third Slovak citizen (35%). The term even outstripped the phrase ‘Slovakia’s accession to the EU’:
http://www.europskaunia.sk/tlac.phtml?ID=1195513&MESTO=eu

² On 2 November 2004 the SME daily newspaper informed its readers that the advertising campaign involving eight PMCs was the biggest ever conducted in Slovakia.

³ In Slovakia the highest proportion of pension contributions in Europe is channelled to the private pre-funded pillar.
public financial resources; pressure from the international financial institutions, particularly the World Bank; political efforts to implement the neoliberal notion of merit in the pension scheme; and the state’s effort to shift the risk of unfavourable developments onto individuals. In examining this hypothesis, a range of methods will be used: primary research of documents issued by relevant domestic and foreign institutions; quotations from the literature to support conclusions; and direct communications with experts on the pension system and pension reform.

Attention should be drawn to the fact that a fundamental part of pension reform – the so-called second pillar – was launched as this paper was being written. This proximity to events might be a handicap in the analysis of the pension reform. For this reason too the available literature is still small. However, this should not prevent us making a start.

**Terminological remark**

It should be noted that several terms will be used in this paper that the author does not regard as fully appropriate or accurate. These terms have, however, become accepted usage in the course of the pension reform debate. The first and most problematic term is pension reform itself. The word ‘reform’ in principle has positive connotations (although less and less so in Slovakia), and should represent an inevitable, partial and favourable intra-systemic change. Slovak pension ‘reform’, however, does not meet any of these criteria: it is not inevitable, it is radical and it brings with it many risks and negative impacts. Furthermore, it does not modify the system, but partially abolishes it. Therefore, it would be more appropriate to talk about dismantling rather than reforming the pension system. In addition, since part of the social security system is being replaced by a system of mandatory saving in personal accounts managed by private companies, it would also be more accurate to talk of social security privatisation. The use of the term pension reform should therefore be understood as being ‘in inverted commas’.

Pension system pillar is another problematic term. Barr (2000: 40) sees the pillar-like categorisation popularised by the World Bank as somewhat misleading, as it focuses on instruments rather than objectives. According to Barr, the objectives should be poverty relief, ‘consumption smoothing’ and insurance. To focus on these objectives, Barr prefers the term tier, for it indicates the type of pension income rather than its source.

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4 The pension reform in the USA is normally called, fairly and accurately, ‘social security privatisation’.
2. Pension system before and after the reform

Reform of the social security system cannot be seen as a one-off affair, but rather as a long-term process. It is not possible to specify the date when the previous system was replaced by the new one. Instead, this section shall briefly describe the functioning of both the previous and the reformed system. It will not concentrate on the transition period of the adoption of key laws, their entering into force and the parallel operation of both systems.

2.1. Before the reform

The pension system before 1989 naturally reflected the political system of the time. Pensions under the state socialist regime were paid out from the state budget. The level of pension depended only very moderately on level of income. Pensions were rather egalitarian even compared to incomes during working life (income differences were much narrower than nowadays) and the system was based on redistribution and solidarity. The pension system before the reform was to a great extent a successor of the socialist pension system.

2.1.1. Legislative basis

The legislative basis of the pension system in Slovakia before the reform was Law 100/1988 on social security. The payment of social security contributions was regulated by Law 274/1994 on the Social Insurance Agency. Law 123/1996 on employees’ supplementary pension insurance was another important legislative document. It created the system that was named the ‘third pillar’ later on in the Pension Reform Concept in the Slovak Republic (hereafter Reform Concept).

2.1.2. Institutional basis

The pre-reform system was institutionally governed by the Social Insurance Agency, launched in 1995. Its creation had been preceded by two cardinal changes in the area of social security since 1989. The first change was the merging of the social security administration and sickness insurance into a single state institution on 1 January 1991. The Slovak Sickness Insurance Administration, the Social Affairs Divisions of the National Committees and the Social Security Office merged to form the Slovak Social Welfare Administration which functioned until the end of 1992. The social sector transformation of 1993 brought with it a change in the institutional system and a new statutory institution – the National Insurance Agency – was established. This change meant a merger of the health insurance administration, the sickness insurance administration and the social security administration into a single institution comprising three independent funds.

According to the explanatory memorandum of Law 461/2003 on social insurance the implementation of a complex tax reform on 1 January 1993 did not provide sufficient tax revenue to finance sickness insurance and social security benefits. It was therefore necessary to provide alternative non-tax resources, namely insurance contributions administered by the National Insurance Agency.

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5 The ideological-political basis of the pension reform and hence the reformed system will be analysed in section 3.

The financing of this institution was set apart from the state budget; its three funds drew money from insurance contributions and partially from the state. The merger of health insurance with the social security funds was eventually considered to be mistaken because of its distinct character which caused problems in the effective organisation of the National Insurance Agency. They were therefore separated and a plural system of health insurance companies and the Social Insurance Agency was created.7

2.1.3. Types of pension system before the reform

Pay-as-you-go pension scheme
There existed two institutionalised types of pension system in Slovakia before the reform. The mandatory, publicly-managed defined-benefit (DB) social security system was dominant. It was financed on a pay-as-you-go (PAYG) basis, by intergenerational redistribution: economically active people, employers and the state contributed to the Basic Pension Security Fund (BPSF) of the Social Insurance Agency. Benefits were paid out directly in the form of pensions from this fund. This system is called the ‘first pillar’ in the Reform Concept.

Revenues and charges of the pay-as-you-go social security system
The revenues of the pay-as-you-go system derived from the contributions of employers, employees, the self-employed and from state and National Labour Office transfers to cover the contributions of the unemployed. Other sources of revenue were transfers from the basic sickness insurance fund and from the reserve fund of the Social Insurance Agency.8

Mandatory contributions to the SIA were regulated by §15 of Law 274/1994 on the Social Insurance Agency. It did not change much, rising from the original 26.5% at the beginning of 1995 to 28% of the gross wage base of assessment at the end of 2003.9 Apart from the old-age pension, this insurance included also survivor and disability pensions.

The Reform Concept states that several kinds of pension benefits were paid out to more than 1.4 million pensioners under this system. These included old-age pension, proportional old-age pension, disability pension, partial disability pension, wife’s pension, orphan’s pension, widow’s pension, widower’s pension, social pension, and so on. Social security benefits were paid from insurance contributions and non-system benefits (wife’s pension, social pension, and so on) from the state budget.

Entitlement to PAYG pensions and pension level
According to §21 of Law 100/1988 on social security men were entitled to retire at the age of 60 before the reform. Women retired on average at the age of 55, depending on the number of children (from 53 for five or more children to 57 years in the case of no children).

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8 Transfers from the sickness insurance fund and the reserve fund started to flow to the pension security fund after it had begun to show a deficit. They are known as ‘cross subsidies’.
Pension calculation was regulated by §12 of Law 100/1988 on social security and based on duration of employment and the best five years’ average income out of the last ten years prior to claiming old age pension, resulting in a so-called adjusted monthly average income: on top of a basic sum of SKK 2,500 was added one third of income between SKK 2,501 and 6,000 and one tenth of income between SKK 6,001 and 10,000. Any amount above SKK 10,000 was not taken into consideration. Duration of employment and work category determined the proportion of adjusted monthly average income\(^{10}\) to which one was entitled. A typical citizen could receive at most 67% of the adjusted monthly average income, if he worked from 18 to the retirement age of 60. Only those who worked even after reaching retirement age or those in work categories 1 and 2 (hazardous jobs) were entitled to more than 67%.

The pension benefit formula was static and did not reflect wage growth and inflation. The growth of wages and prices has been fairly dynamic since 1988, however, when the Law on social security was adopted. To make the pension benefit level respond to cost-of-living increases, laws on pension benefit increases and modifications were adopted every year.\(^{11}\) Pension benefits were supplemented by a fixed amount to cover cost-of-living increases and by a percentage increase to reflect average wage growth. The increase applied to the year the law was adopted.

These laws also regulated the maximum old-age pension benefit level. Pensions had to be adjusted if the cost-of-living index, measured by the Statistical Office from monthly household budget surveys, increased by more than 10%, or the average wage in the economy grew by more than 5%. However, legislation did not specify a fixed percentage increase nor deadlines for valorisation (Goliaš 2004a: 6).

**Voluntary supplementary pension insurance**

Besides the pay-as-you-go social security system there was also a voluntary supplementary pension insurance system in Slovakia before the reform. Its operation was regulated by Law 123/1996 on employees’ supplementary pension insurance. The system consisted of an optional contribution to a personal account with a supplementary pension insurance company. Employers could also contribute. These insurance companies were intended to invest the contributions to increase their value and to pay out the supplementary pension. The system accumulated resources equal to 0.6% of GDP. As the money accumulated in the pay-as-you-go system before the reform represented 8% of GDP, the supplementary pension insurance system can be described as marginal. Apart from the two institutionalised pension systems, a number of other voluntary forms of pension insurance in the broad sense could be included under the Slovak pension system, for example, life insurance, collective investments, savings in banks or other financial institutions, or asset holding.

10 The maximum adjusted monthly average income was SKK 4,067. A person earning on average SKK 10,000 or more during their best five years would receive 2,500 + 1,167 + 400, or SKK 4,067.

11 In some years two such laws were adopted. The total number of laws on pension benefit increases and modifications between 1991 and 2003 was eighteen.
2.2. Pension system after the reform

2.2.1. Legislative basis

The pay-as-you-go system remains in place, but its size and shape have changed significantly. Law 100/1988 on social security was replaced by Law 461/2003 on social insurance, which regulates the mode of operation of PAYG. The pay-as-you-go system forms the so-called ‘first pillar’ of the pension system. Law 43/2004 on old-age pension savings is another key legislative document. The principle of mandatory saving in personal accounts managed by private companies – pre-funded, the so-called ‘second pillar’ – was introduced into the pension system by this law. Law 123/1996 on employees’ supplementary pension insurance (the ‘third pillar’) also remains in place. Its amendment entered into force concurrently with the Law on old-age pension savings on 1 January 2005. The supplementary pension insurance companies were transformed into supplementary pension companies.

2.2.2. The three-pillar model

The mandatory PAYG and voluntary supplementary insurance systems already existed; the reform launched mandatory capitalisation savings. These three sources of pension benefits are named ‘pillars’ in the Reform Concept.

First pillar

The first pillar is defined as the publicly managed, mandatory, PAYG and defined-benefit social insurance (no longer social security) system. The new Law 461/2003 on social insurance introduces a number of changes into the system.

Pension entitlement under the first pillar and pension benefit level

The statutory retirement age has been raised to 62 years for both sexes. All men will retire at the age of 62 from 2006, and all women from 2015. The change will be gradual. A change in the pension benefit formula has significantly modified the PAYG system. The level of pension benefit under the first pillar now depends on length of working life, wages during the whole working career, the performance of Slovak economy, and whether one retires before or after having reached the statutory retirement age.  

The option to retire earlier or later is also an innovation. For every month of early retirement the pension is reduced by 0.5%. Correspondingly, for every month worked beyond the retirement age the pension is raised by 0.5%. To qualify for early retirement, two conditions must be met: (i) at least 10 years of paying contributions to the SIA and (ii) entitlement to a pension at least 1.2 times the subsistence minimum even after the early retirement reduction.

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If not otherwise indicated, information in this section is drawn from MOLSAF advertising materials or the relevant laws.

The pension benefit formula under the first pillar is APWP x R x APV. APWP stands for Average Personal Wage Point and represents the ratio between the individual gross wage and the average gross wage in the economy. A person earning exactly the average gross wage has a PWP of exactly 1.00. R stands for number of years paying contributions to the SIA. APV stands for Actual Pension Value. The pension value is a number directly laid down by law and depending on wage trends in Slovakia. For 2004 the APV was set at SKK 183.58.
The pensions awarded under the new Law 461/2003 on social insurance are indexed automatically, as the APV is valorised annually in accordance with average nominal wage growth in the economy. Pensions are automatically valorised every year by the so-called Swiss method, that is, by the weighted average of CPI (inflation) and average nominal wage growth in the economy. The weights are 0.5 for both parameters (Goliaš 2004a: 9).

Second pillar
The second pillar is a completely new element in the Slovak pension system. It has been possible to join it since 1 January 2005 when Law 43/2004 on old-age pension savings came into force. The pillar is formed by redirecting part of contributions to personal pension accounts managed by pension management companies (PMCs). These private companies seek to increase the value of savings by investing through a selected pension fund. When retiring, the insured individual uses the saved money to buy the second part of the pension in a commercial insurance company (the first one is paid out from the first pillar).

Pension entitlement under the second pillar and pension benefit level
The second pillar cannot be joined by current pensioners or by people with fewer than 10 years to retirement age. These people and those who decide not to join the second pillar between 1 January 2005 and 30 June 2006 will get a pension only under the first pillar. Freedom of choice is available only to those who contributed to the SIA before 1 January 2005 and for those who were paid contributions by the state (students, and so on). People who decide to join the second pillar in the relevant period will get their pension from two sources, PAYG and the pre-funded system. Those who did not contribute to the SIA before 1 January 2005 will also get the combined pension because they are obliged to join the second pillar. For those obliged or who decide to join the second pillar, there will be no turning back. The pension benefit formula valid for those who decide to remain under the first pillar was presented in the previous subsection.

People who decide to join the second pillar will get their pension from two sources. The pension from the first pillar is computed in the same way as for those who do not join the second pillar, but reduced by half (one half of the contributions are not directed towards the SIA but to personal accounts). The level of pension from the second pillar will depend on how much money remains in the account at retirement. That depends on number of years worked, wage level, retirement age, charges for administering and maintaining an account and for purchasing an annuity, and the rate of return from investments. The last factor is an unknown variable that depends on capital market trends, and therefore it is not possible to estimate the level of pension benefit from the second pillar in advance. In other words, pensions under the second pillar are ‘defined-contribution’, not ‘defined-benefit’.

2.2.3. Institutional basis

State institutions
The Social Insurance Agency lost part of its power with the reform. Nevertheless, it remains an important institution within the pension system. It collects all contributions and

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14 In fact, people with fewer than 10 years to statutory retirement age can join the second pillar, but they have to accumulate 10 years in the system. That means later retirement. If they do not meet the 10-year condition, they will receive a pension under the first pillar but reduced by half.
the money of those who do not join the second pillar is managed as before. Half the contributions of those who join the pre-funded pillar (9%) are managed under the PAYG pillar; another 9% is redirected to an individual account in a selected PMC.

The activities of PMCs are licensed and monitored by the Financial Market Authority.

**Pension management companies**

Pension management companies are stock companies which establish and manage pension funds for old-age pension savings. License criteria are regulated by §48 of Law 43/2004 on old-age pension savings. The founders of PMCs have to be credible financial institutions of at least 3 years’ standing. Minimum basic capital is set at SKK 300 million (EUR 7.1 million). Money paid into the second pillar is the private asset of the saver (Goliaš 2004a:12). It is saved in a deposit bank contracted to the PMC. The company deducts 1% from every contribution for administration. It can also charge monthly for asset management in a pension fund, up to a maximum of 0.08% of the net asset value during the first three years. In subsequent years the maximum charge is 0.07% per month.

**Funds and investment**

Each PMC is obliged to create three funds from which the savers can choose. The *Growth Fund* is the riskiest: up to 80% of its portfolio can be invested in equities. As the saying goes, the value of such investments can go down as well as up. Savers with 15 years or less to go before retirement may not hold assets in the growth fund. The *Balanced Fund* represents a more moderate risk: up to 50% of its portfolio can be invested in equities, the rest must be invested in bonds or bank deposits. Only savers with more than 7 years before retirement may hold assets in the balanced fund. The *Conservative Fund* is the least risky: its entire portfolio has to be invested in bonds or bank deposits. There is no age limit on being in this fund.

**Options regarding cashing in pensions and inheriting savings**

There are two options for drawing a pension from the second pillar when retiring. The first is the purchase of an *annuity* in a selected life insurance company, using the money saved in a personal pension account. Under this scheme, however, pension savings are no longer in the saver’s ownership and so of course no longer inheritable in case of death; they are forfeit to the life insurance company. The second option is, again, the purchase of a *life* annuity, but this time with the possibility of withdrawing a portion of one’s savings in cash. Part of the saver’s money in the pension account is used to buy an annuity amounting to at least the statutory minimum level. This money too is no longer inheritable. The remainder of the savings in the saver’s personal account, however, remain in his ownership. He can gradually withdraw funds from his account and in the event of his death it is inherited.

If a saver dies before retiring, the money saved in his pension account is inherited.

**2.2.4. Contribution rate under the reformed system**

The contribution rate to the SIA after the reform is 28.75% of the gross wage assessment base.\(^{15}\) Old-age insurance contributions are 18%: 14% is paid by the employer and 4% by

\(^{15}\) According to §138 of Law 461/2003 on social insurance the maximum assessment base is three times the average gross wage (roughly SKK 45,000 in 2005). Maximum APWP is then logically 3.00.
the employee. An employee can reduce his share by 0.5% for each dependent (having eight dependents means no old-age insurance contributions from the employee; he would contribute just 24.75% of his gross wage assessment base).

People who join the second pillar pay 9% of their old-age insurance contributions to the first pillar (the SIA) and 9% to their personal account in a PMC. The contribution rates before and after the reform are compared in Table 1.

Table 1: Comparison of contributions before and after the reform

<table>
<thead>
<tr>
<th></th>
<th>Before reform</th>
<th>After reform (from 1 January 2005)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Old-age</td>
</tr>
<tr>
<td>1. PAYG pillar</td>
<td>28%</td>
<td>9%</td>
</tr>
<tr>
<td>2. Pre-funded pillar</td>
<td>–</td>
<td>9%</td>
</tr>
<tr>
<td>Total</td>
<td>28%</td>
<td>28.75%</td>
</tr>
</tbody>
</table>

2.3. Summary

Before the reform the social security system was mandatory, PAYG and defined-benefit, with a pension benefit formula. Mandatory contributions were up to 28% of the gross wage assessment base, paid to the statutory Social Insurance Agency, which was also responsible for disbursing benefits. Men retired at the age of 60, women at the (average) age of 55. Besides the dominant PAYG there also existed a voluntary supplementary pension insurance system in Slovakia after 1997.

Since the reform a so-called three-pillar system has been in operation in Slovakia. The first pillar is the successor of the previous PAYG system, with a few differences, such as only half the contributions flowing into the system, a raised retirement age and a pension formula based on contributions rather than on more solidaristic principles. The second pillar represents mandatory saving in personal accounts in pension management companies. Half the savers’ old-age contributions (9%) are directed to these accounts. PMCs invest the money. The savers use the money on their accounts to buy a pension in a commercial life insurance company on retirement. The SIA continues to perform an important role, collecting contributions and administering the first pillar. PMCs are inspected by the Financial Market Authority. The third pillar represents voluntary supplementary pension insurance. An amended law on supplementary pension insurance entered into force concurrently with the law on old-age pension savings.
3. Grounds for the pension system reform

Any politico-economic change requires a rationale. Particularly under a democratic regime this should be serious and legitimate. The Slovak Republic’s pension reform has not only radically changed the way citizens’ pensions are financed, but it will also be very costly.16 This section I will accordingly focus on the grounds that led the government to enact the pension reform.

3.1. Stated grounds

A critical approach is adopted when scrutinising the grounds for pension reform, hence the importance of the distinctions that will be made between the officially stated arguments and the real ones. The former were produced by the pension reform’s authors in order to ensure its legitimacy, social acceptance and popularity. The latter were more relevant in drafting the reform. Counterarguments are also examined in order to test the seriousness and credibility of the officially stated arguments.

3.1.1. Unsustainability of the previous way of financing the pension system

The alleged unsustainability of the previous way of financing the pension system is one of the most frequent arguments put forward by pension reform proponents. This relevant facts here include (i) the regressive balance of the Social Insurance Agency’s basic pension security fund (BPSF SIA), (ii) the fall in the replacement rate17 in the past decade and (iii) demographic prognoses predicting a dependency ratio18 increase in the coming decades. Most of the stated reasons for these problems are related to adverse demographic developments, increasing unemployment and contribution avoidance. However, the problems and the reasons given for them are analysed inconsistently.

It is true that the BPSF’s balance of income and expenditure has been deteriorating (Figure 1). In 1998 the SIA’s current annual income was not sufficient to cover pension payments, and so the SIA had to draw on resources accumulated in previous years (Social Insurance Agency 1999: 12). In 1999 BPSF resources were exhausted completely, which forced the SIA to transfer approximately SKK 2.5 billion from the basic sickness insurance fund to the BPSF (Social Insurance Agency 2000: 13). From 2000 onwards, even the SIA’s reserve fund flowed into the BPSF. However, the main reason for this should be sought neither in PAYG parameters nor in phenomena said to be threatening the system. The most relevant factor in the fall in BPSF finances was a gradual reduction of the state’s payments for ‘its’ insurees19 (Table 2). The state paid social security insurance from an assessment base of 90% of the minimum wage in 1994, whereas in 1997 the assessment base was only 10%. More concretely, while in 1994 the state paid SKK 5.3 billion into the SIA, subsequently payments were gradually reduced, falling to a record low of SKK 0.54

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16 A special section will be devoted to the issue of reform costs.
17 The replacement rate represents the relation between an average monthly old-age pension and an average monthly wage.
18 Ratio of retired people to those of working age.
19 These insurance payments were adjusted by the state every year in a law on the state budget. The range of eligible persons changed over a number of years: until 2003 the state paid for university students, those in military service and those on parental leave.
billion in 1997. The SIA warned that the reduction had had a negative impact on the BPSF’s solvency. However, the state started to increase the payments only after the insolvency became dramatic, between 1998 and 2001 (see Table 2).20

The second alleged indicator of PAYG problems is a decline in the replacement rate (Figure 2). As the figure shows, while in 1991 and 1992 the pension represented 54% of the average wage, it was only around 45% in 2003. However, we should not forget that pensions were paid from the state budget before the National Insurance Agency was created in 1993. This means that pensions did not depend on contributions collected for the purpose: their level and indexation was decided in the parliament. Indexation was determined by the parliament even afterwards – in fact until recently – but the deputies had to consider the financial condition of the National Insurance Agency and, later on, the BPSF SIA. In light of these facts the record replacement rate of 1991 and 1992 seems merely fortuitous. It tells us nothing about the overall state – or crisis – of the pension system. Since 1993, when pensions started to be paid out more or less from what was collected for the purpose, the replacement rate has not changed dramatically, oscillating around 46% (see Figure 2).

The pension benefit formula is another factor to be taken into consideration when talking about the decline in the replacement rate. As already mentioned in section 2, the formula was static and did not reflect wage growth and inflation. Although pensions were indexed by the laws on pension benefit increases and modifications, it was obviously not enough. Insufficient indexation was due to two reasons. The first was the fact that there was no political will or public pressure for a higher pension benefit increase. The second was that funds were lacking. As already mentioned, the state reduced payments, thereby depriving the BPSF of a significant part of its resources.

More detailed analysis, however, makes it clear that the present problems have not been caused by adverse demographic developments. People born in the population boom of the 1970s entered the labour market in the 1990s.21 The problems in question have certainly been influenced by the increase in the unemployment rate, but this is not directly connected to the pension system. Reform proponents do not assert that the new system would solve unemployment.

Another argument in favour of pension reform is based on the proposition that observed declines in rates of return on PAYG systems are indicative of some fundamental flaw in those systems. Orszag and Stiglitz (1999: 19–20) provides counterarguments to contest this thesis. The decline in question reflects the natural convergence of a PAYG system to its mature steady-state, not an alarm signal for radical reform. Analysis of this phenomenon brings us back to the historic moment when the decision to provide pension benefits was made. The first beneficiaries contributed little or even nothing to the system and their rate of return was thus almost infinite. The rate of return for subsequent beneficiaries necessarily declined. The decision to provide pension benefits to those who have not contributed or

20 The fact that the BPSF’s deficit was relatively stable for example in the period between 2000 and 2003 was due to the clearing of the debts of Slovak Railways and of state health care facilities. This merely serves to show that the financial situation in the BPSF is influenced by a variety of factors, not only – journalistically simplified – factors such as demography and contribution avoidance.

21 The demographic problem facing pension systems is often referred to as a ‘time bomb’ in the literature. However, at present there is no demographic problem: the so-called ‘demographic crisis’ is based on extrapolation of present demographic trends into the future (Polák 2004b:11).
have contributed disproportionately little may seem questionable in terms of intergenerational justice. Nevertheless, it has been made. This means that the super-normal rates of return enjoyed by early beneficiaries are the mirror image of the sub-market rate of return on the mature system. Economically, the net present value of the PAYG system across all generations is zero. According to Orszag and Stiglitz, the introduction of individual accounts (that is to say, reform) does not change that conclusion.

The phenomena of demographic development, unemployment and contribution avoidance as the most important stated grounds for the unsustainability of the previous way of financing the pension system will be discussed in more detail in the following sections. For now, in summary: the present problems of the PAYG system have been caused by external factors, that is, by factors which are not part of the substance of the pension system and so cannot serve as legitimate arguments for its radical reform.

Figure 1: Deficits in the BPSF and how they were made good

![Figure 1: Deficits in the BPSF and how they were made good](image)

Source: INEKO.

Table 2: Reducing state social security payments to insurees

<table>
<thead>
<tr>
<th>Year</th>
<th>Payment from base of assessment</th>
<th>Percentage rate</th>
<th>Annual payment (SKK million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>in SKK which is</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>2205 90% of 2450 SKK</td>
<td>26.5</td>
<td>5 268.0</td>
</tr>
<tr>
<td>1995</td>
<td>1960 80% of 2450 SKK</td>
<td>27.5</td>
<td>4 730.7</td>
</tr>
<tr>
<td>1996</td>
<td>1347 55% of 2450 SKK</td>
<td>28.5</td>
<td>3 329.9</td>
</tr>
<tr>
<td>1997</td>
<td>245 10% of 2450 SKK</td>
<td>27.5</td>
<td>539.1</td>
</tr>
<tr>
<td>1998</td>
<td>405 15% of 2700 SKK</td>
<td>27.5</td>
<td>980.1</td>
</tr>
<tr>
<td>1999</td>
<td>405 15% of 2700 SKK</td>
<td>27.5</td>
<td>962.2</td>
</tr>
<tr>
<td>2000</td>
<td>405 15% of 2700 SKK</td>
<td>27.5</td>
<td>733.6</td>
</tr>
<tr>
<td>2001</td>
<td>2400 100% of 2400 SKK</td>
<td>28</td>
<td>3 681.7</td>
</tr>
<tr>
<td>2002</td>
<td>5000 100% of 5000 SKK</td>
<td>28</td>
<td>6 347.6</td>
</tr>
<tr>
<td>2003</td>
<td>5410 100% of 5410 SKK</td>
<td>28</td>
<td>7 312.2</td>
</tr>
</tbody>
</table>

Source: Social Insurance Agency.
Figure 2: Replacement rate development

![Replacement rate development graph]

Source: INEKO.

**Demographic development**

The so-called demographic crisis is one of the most frequently stated grounds for pension reform; it is mentioned in all the relevant materials. According to the MOLSAF publicity brochures, ‘few children are born and people live longer, which means more pensioners and fewer wage-earners to finance pensions’. The Reform Concept states that Slovakia will face population aging in the 21st century. Current prognoses of the Research Demographic Centre state that this trend is irreversible in the time spectrum of the following fifty years. In terms of demographic development it is necessary to apply two basic principles that will ensure sustained resistance by the pension system against population aging: introducing the capitalisation system into the pension system, and postponing the retirement age and equalising it for both genders.

The government’s *Programme Statement* asserts on a similar note that the goal of the reform is ‘to stop the demography-contingent growth of the unfunded pension system’s internal debt’.

As already outlined, the demographic problem does not relate to the present, but rather is based on future development prognoses. A key publication in the Slovak context is *The prognosis of population development in the Slovak Republic to 2050* (Vaňo 2002) issued by INFOSTAT’s Demographic Research Centre (DRC). Virtually all the available materials on pension reform in Slovakia refer to its assumptions and conclusions when discussing demography. The publication’s major message for the pension system is an expected population decrease and an increase in the index of aging: in simple terms, fewer and older people. The most probable variant of the prognosis assumes that the number of citizens will fall below 5 million by 2050. By the same year the prognosis expects the rate of population decrease to be 28,000 persons a year and the index of aging to have reached...
The Slovak Ministry of Finance calculated, on the basis of the RDC’s assumptions, that by 2055 there will be only two persons of productive age (15–64 years) for one pensioner, compared to six persons to one pensioner in 2002 (Ódor et al. 2004:18).

The projected demographic crisis does not hold only for Slovakia. The trend of population decrease and aging relates to the whole European Union. The demographic dependency ratio in Europe is expected to rise from 39.5% in 2000 to 79.5% in 2040. In other words, the number of working age people available to provide for a pensioner is expected to halve from the present EU average of 3.5 to 1.8 in 2050 (Dräger 2003:3).

Shortcomings of demographic prognoses

We need to take seriously demographic prognoses based on firm statistics and it would be politically irresponsible to ignore them. At the same time, one must be prudent and not forget that they are just prognoses, not certainties. The cited RDC study (Vaňo 2002: 11–12) works with eight scenarios of future population development in the Slovak Republic. According to the authors, one variant (no migration) is purely theoretical, two others (very high and very low) are real but not very probable, and the remaining five variants (high, young, old, low and middle) are more or less probable. The middle variant is the most probable of all. If we consider, for example, the expected number of inhabitants in 2050, the probable variants – low and high – anticipate a ca. 20% variation. It is thus equally probable that Slovakia will have 4.5 million as 5.6 million inhabitants in 2050. According to not very probable but still real variants – very low and very high – the leeway widens to 33%. It is thus perfectly possible that Slovakia will have as few as 4.2 million or as many as 6.2 million inhabitants in 2050. These facts are rarely reflected in debates on the demographic aspect of pension systems. Politicians, analysts and journalists should, however, take into account the concluding sentences of the authors of the RDC study:

In the end, what must be stressed once more is the conditionality of demographic prognoses, the present prognosis being no exception. A demographic prognosis is not a forecast; it is a presentation of future developments that may happen under certain conditions. That is how it should be understood and interpreted. Individual variants are assessed in accordance with the probability of the prognosis’s initial assumptions. All the assumptions are based on the present state of knowledge. In demographic processes, however, it is impossible to exclude even highly unlikely changes that are not included in the assumptions of a prognosis. The present development can serve as a good example – nobody expected nor predicted it fifty years ago [author’s emphasis – I. L.]. (Vaňo 2002: 15)

Another shortcoming of the prognoses used to justify the need for radical pension reform is that they take demography into account ceteris paribus: that is, they underestimate the development of other relevant factors. It is thus possible to criticise the catastrophic scenarios of pension system financial unsustainability for ignoring the development of such factors as labour productivity, unemployment, and so on. Dräger (2003: 11)

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22 That means that there will be almost two persons of 65 and over to every person under 18. The index of aging represents the ratio between people of pre-productive age and people of post-productive age.

23 These projections were made in 2003 for the EU-15.

24 The low and high variants for other categories are based on an even wider span of probability in 2050: 24% for the index of aging and 74% for population increase.
Ivan Lesay

compares these reductionist prognoses to those of Malthus. His classical argument at the turn of the eighteenth century, based on demographic expectations, was that Britain would face widespread famine in the long run if the high rates of population growth at the very start of capitalist industrialisation prevailed. While the number of mouths to feed would grow geometrically, the amount of cultivable land would only grow arithmetically. What we are witnessing in current debates on the need to reform pension systems is the same Malthusian argument, but from the opposite perspective: that is, a society with a shrinking number of younger people (or a shrinking workforce in general) will not be able to provide for a growing number of older people. As we now know, Malthus was wrong. He did not anticipate an annual increase in labour productivity of 1.7% over the following two centuries. To avoid repeating Malthus’s error, we should also consider other factors besides demography. At the same time, we should distinguish these factors according to importance.

An important factor in PAYG system sustainability is GDP growth. The Slovak government underestimated this factor when projecting pension system (in)solvency. In the Reform Concept’s financial, economic, environmental and unemployment impacts clause, the government assumes average GDP growth of 1.9% on an optimistic variant for 2010–2085.25 Slovakia experienced an almost identical rate of real GDP growth in 1985–1990 – 1.82%, based on the most conservative World Bank data available (World Bank 1993). This period is commonly thought of as one of deep stagnation. The optimistic variant of the government’s projection thus expects the coming century to be, on average, roughly as crisis-ridden as the twilight years of the Communist regime and about as successful as the period of the pre-War Great Depression. It is hard to believe that such a projection is meant to be taken seriously. If it is indeed intended in all seriousness, clearly the main problem to be faced is how to deal with the stagnant future in general. The problems of the retirement system would in that case be but one, comparatively minor symptom (Polák 2004a: 3).

The likely effects of pension reform on the demographic crisis

Nevertheless, let us assume that the adverse prognoses of Slovak demographists will be fulfilled and that the growth rate of the Slovak economy will average 1.9% a year. What sort of solution would the pension reform represent?

Our starting point is a future situation in which a few productive people have to finance many pensioners. The latter have been saving money on a personal account during their working lives26 in order to purchase a pension annuity. However, as the productive generation is small in size, its economic output is also low; exactly as it would be in the case of an unreformed PAYG system. If pensioners’ savings are in the form of money (for example, government bonds), desired pensioner consumption exceeds desired saving by workers. Excess demand in a goods market causes price inflation, reducing the purchasing power of pensioners’ annuities and wages in the economy, too. If pensioners’ savings are in the form of non-monetary assets (for example, equities), their price will fall as a consequence of insufficient workers’ demand. The real purchasing power of pensioners’

25 This equals the average rate of growth over the decade of the Great Depression in the United States (Henwood 1998: 304).

26 Let us again assume optimistically that their money has increased in value or, at least, has not been devalued.
annuities will thus be reduced again (Barr 2000: 9). As illustrated by both cases, demography and nominal parameters are not as essential as economic output, that is, real parameters. Any pension system will be based on transferring real income from the currently active towards the no-longer-active members of the population. The elderly are always consuming only what is currently being produced for them. A reform which alters merely the form of this transfer, but does not increase the level of income available to society thus cannot solve the demographic problem (Polák 2004a: 1). The theorem ‘adverse demographic development calls for pension system reform’ is still presented in trivial pension reform debates, especially in the media. However, some consistent pension reform advocates are in agreement with this when they admit that the pension reform cannot deal with demographic crisis (Pošvanc 2003, Thomay 2003, Horváth 2003).

The experts discuss one more option by which the pension system may evade the affects of adverse demographic trends, namely investing pensioners’ savings in an economy with a favourable demographic structure (Barr 1999; Goliaš 2004a: 16).

This argument in favour of a capitalisation-based pension system seems reasonable. However, one should not forget that population aging is a worldwide phenomenon and surprisingly holds even for developing countries (see Table 3). As the projected demographic crisis involves all Western countries with minimal divergence, the validity of the argument put forward in the previous paragraph can easily be applied not only at national but at international level. The countries with a relatively better demographic structure have, by contrast, a less developed economy and are problematic regarding, for example, institutional conditions for investment. Investing pensioners’ savings in an economy with a favourable demographic structure thus remains controversial.

### Table 3: Worldwide population aging

<table>
<thead>
<tr>
<th>Portion of population above 65 years (in %)</th>
<th>Support ratio: (20-59 years)/( above 60 years)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000</td>
</tr>
<tr>
<td>Argentina</td>
<td>9.7</td>
</tr>
<tr>
<td>Russia</td>
<td>12.5</td>
</tr>
<tr>
<td>India</td>
<td>5.0</td>
</tr>
<tr>
<td>Turkey</td>
<td>5.8</td>
</tr>
<tr>
<td>Indonesia</td>
<td>4.8</td>
</tr>
<tr>
<td>USA</td>
<td>12.3</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>5.1</td>
</tr>
<tr>
<td>Slovakia</td>
<td>11.4</td>
</tr>
<tr>
<td>China</td>
<td>6.9</td>
</tr>
<tr>
<td>Chile</td>
<td>7.2</td>
</tr>
<tr>
<td>France</td>
<td>16.0</td>
</tr>
<tr>
<td>Poland</td>
<td>12.1</td>
</tr>
<tr>
<td>Hungary</td>
<td>14.6</td>
</tr>
<tr>
<td>Great Britain</td>
<td>15.8</td>
</tr>
<tr>
<td>Italy</td>
<td>18.1</td>
</tr>
<tr>
<td>Germany</td>
<td>16.4</td>
</tr>
<tr>
<td>Sweden</td>
<td>17.4</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>13.8</td>
</tr>
</tbody>
</table>

Source: INEKO.
Increasing unemployment rate

Surprisingly little attention has been paid to unemployment in pension reform debates. The noise around demography obscures the important fact that a decreasing employment rate causes a fall in the number of contributors, thereby further worsening the financial position of the BPSF. MOLSAF itself has not analysed the relationship between unemployment and the financial position of the pension system. To the author’s knowledge, no such study has been produced elsewhere. Nevertheless, the connection is clear: it can also be seen in the mirroring curves of Figure 3: the number of contributors declined in the periods of increasing unemployment; this, together with the reduction in social security payments to insurees, had the most severe impact on the BPSF’s financial position.

Unemployment has another particularly noteworthy dimension. The previous subsection discussed the projected demographic crisis as threatening the pension system and demonstrated that if such a threat indeed exists it relates to both PAYG and capitalisation systems. Focusing on the issue of demography it followed the line of the pension reform debate. However, the debate somehow ignores the seemingly obvious but very important fact that many people in Slovakia are jobless. The core of the demographic argument is formed by the projected decrease in the worker population in relation to pensioners, and seems to rely on the assumption that every citizen of productive age works. This is obviously far from being the case in Slovakia: the unemployment rate has steadily oscillated around 15% since 1999, according to various methodologies. It is thus ridiculous to talk about a projected lack of productive workforce when 15% of the working population are already jobless. For all that, the age structure of the unemployed is quite favourable: according to CLSAF data for the third quarter of 2004, the number of people in each five-year age cohort is similar, the largest group being people aged 20–24. Even if one admits that not all the unemployed really want to find a job and that some do not meet employers’ needs – that, in other words, they do not want or cannot find a job for various reasons – there are still plenty of people who would accept literally any job if they could find it. And that is the problem: there are not enough jobs. In these circumstances, a ‘favourable’ demographic situation with a satisfactory population increase would only make the current unemployment rate worse.

Figure 3: Contributors and beneficiaries compared with the unemployment rate in Slovakia

![Figure 3: Contributors and beneficiaries compared with the unemployment rate in Slovakia](image)

Source: INEKO.
In sum, despite the lack of media and scholarly interest, unemployment is one of the most serious problems threatening pension system stability. Besides that, it offsets the demographic argument because as long as there are unemployed people, the problem is not a lack of children being born, but a lack of jobs.

**Contribution avoidance**

Contribution avoidance is the third ground given for the poor financial position of the PAYG system. Illegal non-payment of contributions is the first form of this. Collection of contributions achieved a rate of something like 94%; that means that the SIA collected around 94% of what it was owed (NASR 2004).

Contribution avoidance is apparently considered a more urgent issue. According to the Reform Concept, contribution payments to the PAYG system are generally perceived as a tax because the old-age pension does not sufficiently reflect the amount of contributions paid during working life. This has allegedly resulted in contribution avoidance, income hiding and shifting, base-of-assessment adjustments, low motivation to find a job, a preference for the grey economy, migration to labour markets with a lower contribution burden, and so on. The pension reform should aim at making contribution payments more acceptable, with as little avoidance by employers as possible. The Reform Concept considers this to be essential for the stability of pension system revenues. The issue of low motivation to pay contributions is similarly perceived in pro-reform literature (see for example Goliaš 2004b: 8–9).

One way to avoid paying part of one’s contributions open to the self-employed, for example, is to reduce their tax base. They surreptitiously include private expenditure in the costs used to reduce the tax base on which they pay contributions. There are several other loopholes like this in Slovak law. According to pension reform proponents, one virtue of the capitalisation pillar is that all contributions belong to savers and, if they die, their children will inherit them. The introduction of hereditary ownership of savings should motivate people not to avoid contribution payments: their money will no longer flow into an anonymous system, but be saved in personal accounts (Goliaš 2004b: 8).

However, there does not seem to be a single estimate of the extent of contribution avoidance, either in the materials supplied by MOLSAF, SIA and the Slovak government or in any other relevant materials or supplementary literature. The assumption that ‘everyone knows people do it’ is considered a satisfactory basis on which to draw conclusions. It is hardly sufficient to justify radical pension reform, however. Even if we admit the validity of this publicly shared impression, it is striking that it has not been given more serious attention. Furthermore, although the introduction of private ownership might increase people’s motivation to pay contributions, the extent of any increase remains in question. The technical feasibility of contribution avoidance remains the same after the reform. If the self-employed have not been used to paying contributions so far, it is not unlikely that they will continue to avoid payment, preferring present expenditure to contributing to a personal pension account payable only in the future.  Of course, administrative costs and negative returns would be deducted from future payments. I shall discuss both risks in more detail.
as personal savings after pension reform, the rational individual of economic theory should reduce present personal savings, thereby reducing the total savings rate.

To sum up, the scale of contribution avoidance remains questionable. The introduction of private ownership of pensioner savings should motivate people not to avoid paying contributions, but to what extent remains unknown.

3.2. Real grounds

One of the main purposes of the present paper is to distinguish the real grounds from the stated grounds for pension reform. Ideological-political grounds intersect the two categories. The paper will also discuss here the influence of international financial institutions and the effort to expand financial markets.

3.2.1. Ideological-political grounds

The authors of the pension reform seek to portray it as far as possible as ideologically neutral, thereby creating the impression of its objective necessity. These grounds include, for example, the already mentioned financial unsustainability caused by demographic phenomena and other objective facts. As Henwood (1994) puts it: ‘Realism, like reasonableness, is a term often deployed to lend an air of inevitability to what are really political decisions.’ The Slovak pension reform is no exception. The credibility of the technical reasons for pension reform have already been examined in previous sections. Nevertheless, reform was motivated not by (supposed) technical reasons alone, but also by ideological-political ones. After all, the authors of pension reform do not even try to disguise their neo-liberal purport. They repeatedly mention earnings-relatedness, justice, freedom of choice and shifting power from the state to the individual.

Merit

Merit is to be an essential feature of the new system. The Reform Concept states that paying contributions to the new pension system should be based on the merit principle of the PAYG system but particularly in relation to saving for old age: the old-age pension should reflect the amount of paid contributions. Strict application of the merit principle should reduce the motivation to avoid paying contributions. According to the pension reform authors, before the reform the system was characterised by a high orientation towards solidarity, taking little account of merit.

The reasoning of the liberal advocates of reform sounds simple and logical: those who pay more into the system during their working lives should receive correspondingly higher pensions. This is indeed legitimate, but it is also an ideological argument and not shared universally. For the moment, we shall skip the controversial issue of whether income is distributed fairly in a society based on market mechanisms and whether there exist different criteria of merit which are socially more just than simple success or failure in the market. Significant income differences are accepted as a fact. Nevertheless, even given this assumption it is difficult to see why income differences from productive life should be transferred to post-productive life. However much they earned during their working life pensioners, by and large, do not work after retirement. Their merit in terms of material production is thus the same. It is true that a better paid pensioner will have paid more contributions into the system during their working life, but only in absolute terms. If we apply a relative approach, both pensioners will have contributed the same. One could even argue that the pensioner on lower wages contributed more, as flat-rate contributions for all...
income groups introduce a regressive element. According to the orthodox economic theory of diminishing marginal utility, contributions of the same proportion of income represent a greater sacrifice for the poor. Merit obviously has a number of facets and it is likely that the neoliberal understanding of this principle would lose at least some of its support if there was a proper public debate.

Barr (2000: 23) refers to one more problem closely connected to the issue of merit. Neoliberals are averse to solidarity-based PAYG systems in which people with very different previous earnings and contribution records end up with almost identical pensions. Such systems disregard the merit principle. However, a similar situation may arise under a reformed DC scheme, when two people of different ages with identical earnings and contribution records may end up with very different pensions. The reason is that the rate of return on financial markets changes over time. There is therefore a real risk that two people with a ten-year age difference and hence also a different retirement age will receive very different pensions despite having contributed exactly the same amount to the pension system during their working lives. As one can see, the reformed system does not offer enough room even for the neoliberal interpretation of merit. This problem is also profoundly linked to the principle of inter-generational justice.

Justice

The very first sentences of the MOLSAF publicity brochures on pension reform say that the pension system is being reformed so that it is more just. Here – and generally in pension reform debates – the criteria of justice and merit are mixed up. According to the study by the Slovak Ministry of Finance, ‘the element of merit has been strengthened at the expense of flat solidarity as regards pension system justice’ (Ódor et al. 2004:13).

Besides justice as merit, *inter-generational justice* is also put forward as justification. The pension reform authors say it would be unfair if the present generation of workers had to provide for the much larger generation of pensioners. This kind of thinking perfectly exemplifies the ideological sources of the new liberalism. First, the elderly are seen here as a ‘load’, ‘burden’ or ‘cost’ to be covered, which illustrates the penetration of purely economic thinking into other spheres: in this case it is the *economisation* of a social problem. Secondly, one can see a strong spirit of individualism and selfishness here: individuals may feel disinclined to financially participate in solving a social problem that does not concern them directly. Etxezarreta (2003: 10) suggests that this selfishness is inconsistent. The current generation that refuses to provide for a larger number of pensioners ignores the fact that it enjoys a much better life because previous generations paid for the investments that led to present wealth. Again, even inter-generational justice has a number of possible interpretations and the neoliberal one should not be taken as dominant.

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28 Baker (2003: 11–12) questions this logic. According to him, economists usually consider after-tax income as the prime measure of living standards. However, the proponents of pension reform have developed a new method, ‘generational accounting’, which explicitly takes the lifetime tax burden as the sole measure of inter-generational justice. By the logic of generational accounting, an age cohort would appear worse off if it had a 5 percentage point increase in its lifetime tax burden, even if it saw a 100 percent increase in its after-tax income compared with a prior age cohort.
Freedom of choice

Freedom of choice is supposed to be another virtue of the reformed system. Economically active citizens will be allowed to decide for themselves whether or not to participate in the reform and, above all, who will manage their money (Goliaš 2004b:14). Ľudovít Kaník, the Minister of labour, social affairs and family, declared that ‘the Slovak approach is the most liberal’ (Jančík 2004: 1) in comparison to countries which have launched a similar reform, for example, Poland, Hungary and Croatia. However, he neglected to mention countries like Lithuania and Bulgaria. In contrast to Slovakia, with its obligatory participation for those not insured in the SIA before January 2005, entering the reformed system is voluntary for everyone in the latter two countries. Even in Hungary, a country he does mention, those choosing to participate in the reformed system can exit it within a certain period if they are unhappy (Farbiaková 2004: 20). There is no such option in the Slovak system which tends to imply that it is not the most liberal after all.

The freedom of individuals to choose a PMC to manage their savings can scarcely be described as a real benefit. Orszag and Stiglitz (1999: 33) cite one research study that revealed that more than half of all Americans do not know the difference between a stock and a bond. There is no reason to believe that the economic knowledge of the average Slovak is much better. Their ability to judge the relative advantages or otherwise of PMCs must also be fairly minimal. The author’s personal interviews showed that even an economics professor does not know which one of the eight PMCs offering the same product (oligopoly) he would choose. The freedom to choose a PMC is therefore merely a formal freedom with no real content. The freedom of individuals to choose is rather a side effect of the primary justification for reform, namely transferring state competences to individuals. Transfer of responsibility suits the state because if the pension system experiences problems (from adverse demographic and/or economic developments) not the state but the affected individuals will be in the firing line. Their pension will depend on their ‘personal decisions’ and on how much they ‘merit’.

The state’s derogation of responsibility for pensions

As we saw in the previous subsection, the neoliberal concept of the minimal state allows for the smallest possible state interference in the lives of individuals. The responsibility for their pension is therefore principally shifted to individuals. Nonetheless, as the paper will try to demonstrate, attempts to derogate responsibility for pensions need not always be due to ideological motives. It can be politically convenient not to take responsibility for citizens’ pensions, no matter what political, philosophical or ideological orientation a particular party may have.

Assuming the future insolvency of the PAYG system in consequence of adverse demographic or economic developments, and assuming we still want to sustain it, any government will have to either (i) reduce pension levels, (ii) raise the contribution rate or (iii) postpone the retirement age, or a combination of the three. All of these measures are highly unpopular. The demographic section tried to demonstrate that the pension reform does not improve Slovak citizens’ situation; it will remain as bad as before, even in the case of adverse demographic or economic developments. However, what the reform can solve is the problems of politicians, at least in the short term. Whereas under the PAYG system the government would have direct liability for unpopular decisions, it cannot be blamed for low pensions under the reformed system, since pension levels are determined by the performance of PMCs and financial markets. The degree of risk from future
3. Grounds for the pension system reform

developments remains the same – it is merely shifted from the state to the individual (Polák 2004b: 12). The reform should therefore be seen rather as a clever accounting trick by politicians (whether social democrats, conservatives or liberals) who naturally prefer that others be the bearers of bad tidings. In the Slovak case, it will be the market. In the welfare state literature, especially concerning strategies to minimise the political cost of retrenchment, this technique is called ‘passing the buck’ (Weaver 1986: 386–387). Politicians will always try to avoid unpopular decisions. However, if a decision has to be made which is likely to incur blame, they will try to pass it on to someone else or to introduce an apparently automatic mechanism that (meeting certain input conditions) will take the decision as it were of its own accord. This is how things stand with Slovak pension reform.

Risk of political irresponsibility

The pension reform advocates argue that under the previous system there was a major risk of politically irresponsible behaviour, ignoring the real state and financial position of the PAYG system. By contrast, the new system with private ownership of a part of contributions reduces the room for political manipulation, as politicians cannot touch the private savings. This argument is certainly relevant. Nonetheless, one should not forget that politically responsible behaviour is necessary even under the new system, especially as regards regulation. According to Orszag and Stiglitz (1999: 32), it is difficult to believe that a government that is inefficient and corrupt in administering a public benefit system would be efficient and honest in regulating a private one. Considerable government regulation is essential to avoid investments that are overly risky and managers who are fraudulent. In the Slovak context, it is important to mention that this kind of risk is especially acute in countries with poorly developed capital markets.

The Slovak path to the liberal welfare state

The ideological features of the Slovak pension reform mentioned so far clearly document the change of course from the old socialist to the new neoliberal type of welfare state. In

29 As the reform has no impact on total economic output, it can only change its redistribution. Pensioners can thus have lower or higher pensions than under PAYG, but at their own expense. The situation of individuals is therefore the same as if the contribution rate had been raised or pensions reduced under PAYG.

30 Of equal relevance, however, is the counterargument that the risk of the reformed system lies in financial market volatility. This issue is discussed in more detail in a special subsection. Here, we shall merely state that it is irrelevant for an individual whether he loses money due to irresponsible politicians or unfavourable financial market conditions. In fact, a publicly run system has at least two important features. First, politicians can be monitored and if the citizens are not satisfied, they will not re-elect them. Despite all the shortcomings of representative democracy in Slovakia – for example, insufficient awareness and involvement, even apathy, an opportunity to cast a vote only once every four years, and so on – there is at least a possibility of influencing the course of events. Nevertheless, the behaviour of private companies and capital market developments cannot be influenced by individuals even theoretically. Second, the state can use the collected contributions irresponsibly in two ways. Besides the widely discussed corruption and other forms of misappropriation, the state may manage contributions irresponsibly in the sense that it does not use them for the original purpose of paying out pensions. It is true that pensioners’ money can be used, for example, to help the situation in an economic depression, but only on condition that during the following period of economic expansion it is ‘returned’. In the case of private PMCs and capital markets, there is no evidence of similar situations of using collected funds for a purpose beneficial to all citizens.
the classical welfare state regime classification of Gøsta Esping-Andersen (1990), the Danish scholar distinguishes between social-democratic, corporatist and liberal welfare state regimes. Social-democratic welfare states are characterised by generosity, universality and equality in benefit levels. By contrast, social provision in the form of a minimal ‘safety net’, limited access to and a low level of benefits are features of liberal welfare state regimes. Finally, corporatist regimes are characterised by a strengthening of existing income and social differences. The variety of these welfare state regimes is reflected in three pension system dimensions: redistribution, certainty and universality (Polák 2004b: 7).

The previous social security system in Slovakia was characterised by fairly high standards of solidarity, involving redistribution from richer to poorer; its defined-benefit character constituted a legitimate claim to a pension, which represented a significant guarantee; and practically everyone was entitled to pension benefits, and so the system was universal.

The reformed system virtually does away with redistribution; it is also difficult to describe it as offering any kind of guarantee because, except for the total amount of contributions, the pension benefit level depends on the performance of PMCs and capital market conditions. Nothing like a citizenship-based right to pension benefit exists. The Slovak semi-liberal regime is actually so radical that its ‘safety net’ does not guarantee even the subsistence minimum. In November 2004, several parliamentary deputies tried to pass a law that would introduce a minimum pension benefit at subsistence level. However, they did not succeed. On 29 November 2004, MOLSAF spokesman Martin Danko commented to the Pravda daily paper: ‘It would be unfair’. One could hardly find a clearer declaration of the ideological basis for the pension reform and the direction of the Slovak welfare state.

3.2.2. Influence of international financial institutions

The Slovak pension reform is not an original creation. In its preparation there was much reference to examples from abroad and much inspiration was drawn from the models developed by the international financial institutions. The aim of this section is to document the involvement of international financial institutions in the Slovak pension reform, thereby exposing another significant argument behind it.

World Bank

The World Bank (the Bank) is one of the strongest financial institutions in existence. A majority of the world’s countries participate in its loan programmes. This section will first look briefly at the Bank’s general involvement in promoting reforms in Slovakia, then focus on Slovak pension reform, and finally mention several examples of the Bank’s involvement in pension reform in other countries.

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31 The classification will be discussed in more detail in section 7.
32 By the way, this diverges significantly from the government’s Programme Statement. In the part on pension reform it declares: ‘The government will secure a minimum guaranteed old-age pension benefit for citizens in at-risk social groups and who will not be able to participate in saving by means of individual accounts.’
The World Bank started to be more active in Slovakia after the change of government in 1998. The most important of the Bank’s activities were conducted within the framework of the so-called Country Assistance Strategy (CAS). According to the Bank itself, the CAS programme is designed to assist Slovak reforms implemented after the 1998 elections. The level of a loan available from the programme depends on how the government meets criteria set by the Bank. One of the basic criteria for receiving the maximum loan of USD 765 million from 2001 until 2003 was to push through rapid implementation of structural reforms (those affecting large sectors of the economy), for example, selling state shares in the SGI, restructuring the electrical energy sector, and – most important for our purposes – reaching a decision on financing the pension reform (Habšudová 2001).

The World Bank and pension reform in Slovakia

There is more than enough evidence of the Bank’s substantial interest in pension reform in Slovakia. For example, it granted a loan for this purpose. On the Bank’s official webpage where it details its activities in Slovakia, it states that ‘the World Bank is helping to introduce a modern pension system in Slovakia ... [and] has helped introduce mechanisms to improve the collection and administration of contributions to a multi-pillar pension system’. In March 2004, the Bank issued the document CAS Progress Report for the Slovak Republic in 2004: Information Submitted to the Operation Committee of the World Bank. This document states that ‘the new pension system was approved in 2003 but it is necessary to adopt implementation measures soon because the new system should commence operations in January 2005’ (p. 17). The first of the Bank’s key priorities in Slovakia in 2004–2006 has been ‘fiscal consolidation (public expenditure reform)’, including ‘pension system reform’ (p. 40). Another Bank document (World Bank 2002: 127, 133) can also be labelled absolutely pro-reform. By way of illustration: ‘Therefore to avoid a disastrous deficit and ensuing macroeconomic instability, reform is unavoidable. ... Introducing the second pillar will create an opportunity for higher pension benefits’ (italics in the original).

The World Bank presents its priorities regarding the development of the Slovak pension system not only in its own documents, but also in the media and in academic papers. For example, the chief economist in the Bank’s social protection department Hermann von Gersdorff displays a clear preference in the Trend weekly, saying that ‘the budget deficit

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33 For a more detailed discussion on World Bank and International Monetary Fund activity and its impact in Slovakia see CEPA (2000).

34 According to Mihók (2004), the CAS influence on state economic and development policies is significant, particularly in developing countries, countries with transition economies, states with huge budget deficits and a long-term lack of public funds for reforms and public projects, and also countries with weak governments. Governments that do not have financial resources for economic reforms and cannot get them nationally usually succumb to the conditions specified in the CAS. The Slovak Republic closely cooperates with the Bank and the IMF, notably since 1998. It has received several loans from the Bank, for example, for clearing the debts of commercial banks before their privatisation, public finance management reform, pension reform, health care reform, and so on. As Mihók concludes, considering the fact that most of the reforms supported by the Bank are in their initial phase and the government plans new reforms without the resources to carry them out, the influence of the new CAS Progress Report (the CAS update for the next three years) on economic and development policy in Slovakia will be considerable.

caused by the pension reform in Slovakia is just an accounting problem and it would therefore be calamitous to change the proportion of contributions to the detriment of the capitalisation pillar' (Záborský 2003). Other Bank economists state in a paper on pension reform in Europe (Holzmann, Orenstein and Rutkowski 2003) that if Slovakia does not undergo structural reforms or does not raise the pension contribution rate, the replacement rate will fall from the present 42% to only 19% by 2040. Even the remaining assumptions and recommendations of the Bank’s paper conspicuously resemble the intentions, declarations and actions of the Slovak government in this field.

Granting a loan to the Slovak government for the purpose of reforming the pension system is another unmistakable sign of the Bank’s involvement. The submission report Draft Credit Contract and Subcontracts between the Slovak Republic and the World Bank on the Social Benefit Reform Administration Project states:

The Social Benefit Reform Administration Project’s primary objective is to support the government’s plans for pension reform. The project’s purpose is to develop a plan for pension insurance reform, declared a priority by the Slovak government. Creation of an individual account client database, introduction of a joint contribution collection system, as well as building up a multi-pillar pension insurance system are further goals of the project. [author’s italics – I.L.]

Interestingly, the cited document states that at the Bank’s request, the credit contract and subcontracts may not be made public. This only serves to corroborate the accusations of a number of NGOs concerning the Bank’s lack of transparency.36 Another document related to the credit contract – the so-called Project Information Document (PID) – only repeats the Bank’s previous recommendations to the government: complementing the PAYG pension system with a multi-pillar system, promoting the transition from a benefit-based system to an insurance-based system, improving social assistance targeting, and making the system more efficient and cost-effective.

The Bank’s demands are reflected even in Slovak legislation. The submission report of Law 461/2003 on social insurance demonstrates this: it noted that the draft bill had been amended to take into account the World Bank’s conditions on its proposed loan for social security reform.

It expressly follows from what has been said so far that the Bank has been a dominant influence in the inspiration, preparation and implementation of pension reform. In the cited Project Information Document, the Bank prides itself on its unique experience compared to all other donors in the area of developing successful multi-pillar systems. According to the document, the Bank will enter into full dialogue with the Slovak government through the provision of technical assistance to support pension reform. The following quotation from the credit contract submission report illustrates the particular form of ‘full dialogue’:

The documents that resulted from the negotiation process are standard World Bank documents adjusted in accordance with the needs of the Slovak Republic and they are unalterable. Within the framework of the credit contract and subcontracts approval process in the World Bank Board of Governors, the World Bank must receive a letter from

36 See CEPA (2000).
the government of the Slovak Republic confirming that it agrees with the abovementioned documents. [author’s italics – I.L.]

Procedures of this kind (as well as contract secrecy) are probably usual for the Bank when granting a loan. Nevertheless, subjecting loan provision to various criteria can hardly be called full dialogue or negotiation. The fact that the government must send an agreement letter to the Bank is also noteworthy. Signing a bilateral agreement after the ‘negotiation process’ would appear to be a more proper way to go about it; however, it would not create the impression that the original and primary reform initiator is the Slovak government. If the Bank intended to create such an impression, it definitely succeeded.\(^{37}\) As both the Slovak government and the World Bank have produced similar rhetoric, it is difficult to tell who has followed whom. It is quite possible that the information flow is bidirectional, but the quality is probably different. Whereas the Bank provides the model and economic-ideological coverage, the Slovak government supplies statistical data that are later processed and used by the Bank to provide additional underpinning. The intertwining of arguments and statements from both actors continues. However, given the economic (thus also political) power of the Bank, its longer history of reflection on pension reform, and the conspicuous resemblance of the Slovak reformed system to the model promoted by the Bank all over the world, it is evident which actor played the dominant role in the alleged ‘full dialogue’. Of course, it must be said that the economic-ideological likemindedness of the Bank and the Slovak government significantly facilitated the whole affair. To show that the ‘negotiated’ documents were not called forth by the specific needs of the Slovak Republic, we shall now look at the Bank’s efforts to implement its model all over the world regardless of the national context.

The World Bank and pension reform

To document the Bank’s activities throughout the world in the field of pension reform, it is helpful to consult its official webpage. Immediately on opening one can see how important this issue is for the Bank: the second banner is devoted to the issue of pension reform (the first relates to reconstruction of the Southeast Asian regions damaged by the tsunami of 2005). In the part on pension systems it states that they are a relatively new area for the World Bank, which has been increasing its lending and technical assistance in this area since 1990. The Bank is engaged in pension system reform work in thirty countries, through adjustment lending, project lending and technical assistance. The Bank’s concerted efforts in this area were heightened with the publication of *Averting the Old Age Crisis* in 1994 (World Bank 1994).\(^{38}\) The Bank advocates the multi-pillar approach on its webpage. There is no need for a detailed description here; a look at the Slovak reformed system gives us a clear idea. To summarise, the public pillar, funded by payroll taxes or general revenues, focuses on redistribution. The second pillar is a funded

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\(^{37}\) The reason why the Bank is likely to be interested in receiving an agreement letter from the government is to provide it with an alibi; the intention is to conceal the fact it was the Bank which initiated the whole project. The World Bank is also often criticised for a lack of transparency and legitimacy (the citizens of member states cannot democratically influence its personnel and activities), therefore it is more convenient for the Bank when the initiative comes at least formally from a legitimately elected government. These procedures are not specific to the Slovak Republic; they are standard.

\(^{38}\) As Orszag and Stiglitz (1999: 2) put it, the approach delineated in the publication itself is expansive enough to reflect any potential combination of policy responses to the pension reform challenge. In practice, however, the three-pillar model has been interpreted as the only message of the publication. Indeed, the Bank itself fosters this interpretation, as demonstrated in the following lines.
system, where individuals’ mandatory contributions are saved and invested to pay for their future pensions. This allows individuals to save for their own old age, and generally there is no redistribution. Finally, the third pillar represents voluntary savings, allowing individuals to choose how to allocate their income over their lifetime.39

In the PID paragraph setting out the rationale behind involvement in Slovakia, the Bank says ‘it has been proven to be a leader in coordinating dialogue on pension reform and has helped many countries in the region develop successful multi-pillar systems’. The endeavours of the Slovak government serve as an example to other countries in the region which have been considering a re-design of their contribution systems.

Remaining in the Central and East European (CEE) region, Slovenia is one country the Bank believes will follow the example set by Slovakia.40 According to several macroeconomic and living-standards indicators, this former Yugoslav republic is the most developed post-communist country. The World Bank itself classifies Slovenia as a high-income economy. The Slovenian pension system is in extremely good condition; the replacement rate (pensions to wages) was as high as 76.1% in 2000. Despite this, the Bank is convinced of the general applicability of its model and within the framework of its worldwide mission it has tried to persuade even the Slovenian government to introduce pension reform and to take out a loan for its implementation. The Bank financed an international conference on pension security, a workshop on the capitalisation pillar, educational journeys abroad, and also commissioned Slovenian economists to carry out a study on the prospects of pension reform realisation. However, the results of the study demonstrated that the pension reform would not be worth carrying out, mainly because it is too costly. The government adhered to the recommendation, implementing a mere parametric reform of the system, and refused the Bank’s ‘help’ (Topol 2004a). One can only regret that the actions of the Slovenian government did not serve as an example for the Slovak government.…

World Bank pension reform activities: a critique

In light of both the Bank’s own declarations and the Slovenian case, one must agree with those critics who accuse the Bank of pushing carbon-copy reforms in countries with completely different economic, social and demographic structures. The push for reforms even in developing countries where prognoses of pension system development are not particularly threatening is striking. The Bank has no logical rationale for reforming the pension systems of these countries.41 However, there is an obvious reason why they have nevertheless done so: the countries are poor and have weak governments, and so they will not dare to refuse the offered loan and pension reform assistance (see note 34).

The Bank’s approach to pension systems has been criticised for a number of reasons. For example, Henwood (1994) challenges the Bank’s presentation of the elderly as a ‘burden’


40 Apart from Slovenia, the only Central European country that has not undergone a fundamental pension system reform is the Czech Republic. Both exceptional cases will be discussed in the final section of this paper.

41 Even though, as demonstrated in the subheading on demography, even the decision to reform a pension system based on adverse demographic development projections lacks logic.
on the rest of society.\footnote{This approach is visually illustrated in a vulgar TV commercial for the Aegon PMC, where parents are portrayed as literally sitting on their adult children’s shoulders.} According to the Bank, older people are not to be cared for or cherished; instead, they are a cost that has to be minimised in the name of fiscal prudence, growth and productivity.

Of course, the World Bank’s seminal publication in this area – *Averting the Old Age Crisis* (World Bank 1994) – has not avoided criticism. According to Barr (2000: 39), rational policy design starts by agreeing objectives and proceeds to a discussion of the instruments for achieving them. The World Bank analysis can thus be criticised because its categorisation focuses on instruments rather than objectives, thereby presupposing the choice and mix of instruments.

Minns (2003: 2) offers another line of attack. He reminds us of the paper’s subtitle: *Policies to Protect the Old and Promote Growth*. The word ‘and’ is highlighted in the original and, according to Minns, is the crucial connection in the Bank’s theory of pensions and the economy. The World Bank argues that cutting public expenditure and increasing private provision would lead to greater private savings, and so greater private investment, and hence greater private production and GDP growth, resulting in a greater ability to pay for the increasing ‘burden’ of ageing societies. However, Minns says that no part of the theory has been proven.

Another shortcoming has been identified by Baker (2003: 12). The authors of the analysis sought to portray the prospect of higher future tax burdens – even if accompanied by higher after-tax incomes – as an economic disaster. Worldwide population aging could thus be presented as a crisis. The irony of this approach, Baker says, is that with few exceptions, the projected increase in the share of GDP needed to support the elderly in the *thirty or forty years following* the publication of this volume, was approximately the same as the increase over the *prior thirty or forty years*. In other words, the analysis could have been written with as much validity in 1954 or 1964 as in 1994. As Baker concludes: ‘The fact that institutions like the World Bank, the International Monetary Fund, and the Organization for Economic Cooperation and Development have been so eager to regard the continuation of a decades old trend as a “crisis” raises serious questions about their objectivity on this issue.’

**International Monetary Fund**

The International Monetary Fund is considered to be the World Bank’s twin in the area of international finance. The Bank often sets adoption of the Fund’s structural adjustment programmes as a criterion for granting a loan. The IMF serves, so to speak, as a ‘gate-keeper’. Regarding the lack of transparency in the IMF, there is not as much evidence of its involvement in the Slovak pension reform as in the case of the Bank. Nevertheless, enough evidence is available to indicate the Fund’s preferences. The Fund has two concerns in particular: first, that the costs of reform do not jeopardise budget solvency and so affect currency stability; second, that the capitalisation pillar will result in capital market development in Slovakia. These preferences can be documented by means of official papers.
On 7 May 2003 in Article IV of the Consultation Mission’s Preliminary Conclusions, the IMF states that pension reform is key to achieving a sustainable long-term fiscal position. The report goes on: ‘The planned second pillar could be a golden opportunity not only to reduce the burden on the first pillar, but also to promote old-age security by diversifying the sources of retirement income, and to assist the development of Slovak capital markets.’ The Fund further warns that the large-scale diversion of contributions from the first to the second pillar could potentially complicate efforts to meet the Maastricht fiscal deficit criterion. Privatisation receipts set aside for the reform will play an important role in financing the deficit, the IMF claims.

As in the case of the Bank, the IMF’s preferences found their way into the official documents of the Slovak government and into legislation. The 28 March 2001 government session resulted in the Resolution on economic policy for the purposes of the IMF staff monitored programme. Point 22 of the Resolution states that the Law on social insurance will significantly improve the financial position of the present pension insurance system and get it ready for complex pension system reform. In the Resolution the government committed itself to start work on the second pillar of pension insurance under which insurees will contribute to personal accounts managed by companies they choose themselves.

The government carried out its pledges and implemented them in law. Work on the second pillar started (remembering that designing the pillar did not take much time because the know-how was supplied by the Bank) and this pillar has now been put in place. The IMF remained true to its name and its conduct was entirely in character: the recommendations and comments on pension reform exclusively concerned currency stability and the prospect of capital market expansion, hence taking a rather narrow economic (or even narrower financial or monetary) approach to pension reform in Fund papers.

3.2.3. Efforts to expand financial markets

The previous section documented the involvement of international financial institutions (especially the World Bank) in pension reform in Slovakia, but also abroad. It identified this involvement as one of the reform’s driving forces. However, one might ask why the international financial institutions are so interested in the implementation of reform. The following brief, but telling quotation will hopefully make the approach easier to understand:

It seems clear that the supply of a regular flow of funds for the financial markets and of profits for financial capital and the financial players involved (insurance companies, pension funds, banks, unit trusts, etc.) are the paramount objective of this transformation, regardless of the economic cost for the countries involved and of the increased risk and deterioration of the welfare of European citizens. (Etxezarreta 2003: 19)

The international financial institutions have, of course, their own economic-ideological reasons for promoting reform. One should not forget the interests attached to grant loans, either. However, these institutions are primarily instruments: they provide broad lobbying

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43 See, for example, the submission report on Law 461/2003 on social insurance. In connection with equalising the retirement age for both genders, the government refers to the staff monitored programme again.
space for actors such as big financial, commercial and industrial companies, front
groups, national governments, and so on. The international financial institutions try to
promote the interests of these groups, thereby providing a partial explanation for their
efforts to promote the reform (privatisation) of public pension systems, so redirecting
public finances to capital markets where the money can generate profits. Even now,
pension funds are the main institutional investors in capital markets (Staněk 2003: 52).
Their power and influence, both in international financial institutions and in national
governments, should not be underestimated.

The fact that institutions in which pensioners’ welfare is secondary to profit are to be
responsible for a significant part of pension income raises many questions. According to
Minns (2003), the central questions relating to the pension system are: who controls
delivery, how is it accomplished and who gets most out of it, the deliverers or the
supposed beneficiaries? If it is a welfare issue, it should be the latter. If not, it will be the
former. The central objective of financial institutions is not the delivery of welfare, but the
production of a sufficient margin to make the delivery of welfare profitable. The potential
welfare of beneficiaries (pensioners) is likely to be at best only a side effect of profit
making. None of the eight PMCs offering services under the Slovak second pillar are
charitable or mutual organisations. All are primarily profit-oriented and if they had not
anticipated gain, they simply would not have entered the sector. On one level, this is a
commonplace idea, but the manner of the PMCs’ involvement has not been the subject of
debate.

Efforts to build up an integrated European pension market

The current reform-trend towards pension capitalisation is thus beneficial for institutional
investment. Institutional investors in Central and Eastern Europe – as well as within the
rest of the EU, because of the ongoing integration – will benefit from pension privatisation
in post-communist countries due to an enlarged clientele and access to their savings
(Wehlau 2003: 7).

The issue of European integration is important here for another reason. As Etxezarreta
(2003) points out, besides profits for institutional investors, the expansion of capital

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44 So-called ‘front groups’ are civic organisations, institutes and other NGOs financed, for example, by
corporations, but presenting themselves as neutral and independent groups working in the public interest.
As an example, we can use the case of Dow Chemicals’ sponsorship of the Alliance for Responsible CFC
Policy or a lobby group dominated by British and Dutch funded pension interest groups which finances
the European Federation for Retirement Provision. For more on front groups, see the brilliant analysis by
Beder (1997).

45 However, national governments are often no more than the outstretched hand of various national groups,
especially strong private sector lobby groups.

46 Any attempt to start a serious debate on this issue would have no chance of making headway against the
massive propaganda of the Slovak government and PMCs, who talk only of higher pension benefits but,
quite understandably, do not say a word about the PMCs’ profit motive.

47 These investors have hitherto tried to sell their services within the framework of voluntary supplementary
pension insurance (under the Bank model known as the third pillar). However, the participation rate was
very low despite several tax breaks: only 0.02% Slovenian citizens a year participated. In Slovakia, the third
pillar accumulated assets amounting only to 0.6% of GDP, whereas PAYG system expenditure totalled 8% of
GDP before the reform. That is why institutional investors are trying to promote a reform that will
redirect as much of the revenue flow as possible from the PAYG to the capitalisation system and make
capitalisation mandatory.
markets also serves to further the EU’s politico-economic ambition to create a new ‘European financial architecture’ to achieve homogeneity of capital markets and so boost their competitiveness. The logic of these efforts is simple: the more privatised pension systems there are in the EU, the more capital will flow into the (single) European capital market, making it more powerful and better able to compete on equal terms with Wall Street and Tokyo.

The EU’s own statements can be adduced in support of this thesis. According to a 2002 internal EU paper entitled ‘An Integrated European Pension Market’ (cit. Štaněk 2003), the EU has developed an integrated European pension market scheme which is to constitute the fundamental pillar of all EU countries’ pension system reform. It contains the design of the so-called second and third pillars: the second pillar is mandatory and prefunded, while the third consists of voluntary and supplementary insurance, exactly as in the World Bank model. Štaněk says that the use of the so-called long-term resources obtained by means of the second and third pillars will be crucial for financing enterprise development. In another paper, the European Commission (2001) calls for a comprehensive approach which will involve continuing pension reforms in member states, including allowing private pension schemes to take full advantage of the EU internal market. More specifically, a recommendation to the Slovak Republic written by the European Commission’s DG Economic and Financial Affairs in 2002 states: ‘The government should further elaborate and implement its strategy for the non-bank financial sector while ensuring its stability – not least with a view to fully exploiting the beneficial effects on financial markets which could arise from the planned introduction of a pre-funded pension component.’ EU influence over the pension reform policy of its member states is also indicated by efforts to reduce the limits on investing in foreign pension funds. Originally, as much as 80% of investments had to be bound to Slovakia. This was later reduced to 50% and at present it is only 30%. The investment limit has been reduced because it is not in accordance with EU rules on free movement of capital (Goliaš 2004b: 24). This supports the argument that the EU is trying to create a powerful and homogenous capital market.

Slovak pension reform has been shaped not only by the ideological-political preferences of its authors, but also by the influence of international financial institutions, especially the World Bank. Institutional investors are also important actors. Due to their size and power, they are able to promote their own interests directly in international financial institutions and national governments. The intensifying efforts of the European Union to homogenise and consolidate a European capital market to make it more competitive is another important reason for promoting pension reform. Diverting part of public finances to the management of institutional investors makes this easier.

3.3. Summary

In this, the longest section of this paper, the aim has been to map the reasons put forward for pension system reform in Slovakia. The distinction between stated and real reasons has

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48 Concerning the USA, we must add that this country faces similar trends. Social security in the United States is under serious threat. This is not a result of its financial situation but, as in Europe, the power of the financial interests which stand to gain by its dismantling and the fact that these groups have largely been able to control the flow of information to the public on this issue (Baker 2003: 11).

49 For more detailed documentation and analysis of the EU’s attempts to influence its member states to reform their pension schemes see Dräger (2003).
proved crucial. After scrutinising the argument concerning the unsustainability of the previous way of financing the pension system, I concluded that its regressive condition was not caused by its structure, but by external factors which do not form part of the pension system and which remain untouched after the reform. Unsustainability is relevant only on the basis of long-term future development prognoses, but the shortcomings of these prognoses, together with the fact that the reform will not solve the system’s problems even if the prognoses turn out to be correct, lead us to the assumption that unsustainability is merely an artificial argument that serves only to veil the real grounds for reform. These include the ideological-political motivations of the pension reform authors, the influence of international financial institutions and efforts to expand capital markets.

We have identified ‘merit’, justice, freedom of choice and motivation to pay contributions as the main ideological motives. A more detailed analysis has shown that the neoliberal interpretation of these criteria is reductionist. What is more, the reform’s outcomes are often inconsistent even with neoliberal ideas. The state’s efforts to derogate responsibility for pensions is another ideological-political ground for reform. The view that the state should play a minimal role and that people should take care only of themselves is the ideological (in this case specifically neoliberal) element here. The political element consists in the attempt by politicians (of whatever political orientation) to shift responsibility for protection people from prospective adverse demographic or economic developments to an automatic mechanism (for example, the market) and thus avoid having to make unpopular decisions.

The last part of this section focused on the involvement of international financial institutions in the pension reform, as well as the endeavours of institutional investors to expand capital markets through the inflow of public finance. Particularly important in this connection are the intensifying efforts of the European Union to homogenise and consolidate a more competitive EU capital market.
4. Risks and social impacts of reform

Unfortunately, this issue has so far been paid little attention. The first, fairly obvious reason for this information vacuum is the interest of both government and PMCs in consolidating the reform’s credibility. They are therefore reticent about its risks and adverse impacts, mentioning them only if they have to.50 Secondly, the pension reform is a huge experiment whose impacts are hard to anticipate. Examples from abroad51 and future trend prognoses will be used in an attempt to make some progress on these issues.

4.1. Risk: diversified or increased?

The pension reform authors proclaim it a particular virtue of the new system that the risk of adverse developments can be spread over a number of ‘pillars’. One of the draft documents preceding the development of capitalisation-pillar legislation states:

The creation of the capitalisation pillar will constitute a change from the one-source PAYG financed pension system to a multi-source mixed financed pension system. The advantages are obvious; the very elements are balanced by spreading the risk between the labour market (contributions flowing to the PAYG pillar) and the capital market (contributions flowing to the capitalisation pillar). The pension system can thus respond in accordance with the risks of demographic developments which influence the PAYG component, as well as the risks of capital market volatility which influence the capitalisation component.52 [bold in original]

World Bank chief economist Anita M. Schwarz expressed herself in the same way in an interview for the Pravda daily. If the citizens receive a pension from two sources, the likelihood of the system’s failure will be reduced, she said (Makarová and Farbiaková 2004: 20).

Of course, the ‘three-pillar’ scheme seems at first glance to be quite logical. However, the same logic might bring us to the question of whether it would not be better to diversify the pension system by setting it on even more pillars, say five or ten. Another rhetorical question might be: Can we reduce the risk of a system founded on a relatively solid base if we destroy one half of it, re-establishing its foundations in the sand of a capitalisation pillar which is inherently unstable and risky? In other words, risk diversification is not so

50 According to the law, the PMCs are required, for example, to include a warning in their advertisements stating that investing in financial markets is risky and therefore the level of pension benefits cannot be guaranteed. The ‘willingness’ of PMCs to present this risk is illustrated by its relegation to the small (indeed almost invisible) print. What is more, at the beginning of their advertising campaign, the PMCs ignored this requirement completely, meeting their obligations only after being served notice by the Financial Market Authority.

51 A similar system has worked for an extended period only in Chile (see Box 1). However, because of the long transition period it is not possible to survey the final impacts of the reform completely, even in this pioneering country.

52 Once again, we must return to the argument put forward in the section on demography: adverse economic or demographic developments threaten not only the pension system dependent on the labour market, but also the one dependent on the capital market. The capitalisation component does not really change a thing.
simple. The capitalisation pillar, while reducing a few risks characteristic of the previous system,\textsuperscript{53} itself introduces many new risks unknown so far. This will be discussed below.

### 4.2. Uncertainty

#### 4.2.1. Risk of capital market fluctuations

We have mentioned uncertainty several times. Right at the beginning it was stated that before the reform the system had been \textit{defined benefit}, whereas the reformed system is \textit{defined contribution}. Under the defined benefit system, the pension benefit formula was laid down by law; everybody knew what their pension payment would be. The state undertook to make up the difference if contributions were insufficient to cover costs. That is, the risk was borne by the pension programme’s ‘sponsor’, namely society as a whole (or, strictly speaking, its productive part). The present system predetermines only the level of contribution. The level of pension benefit to be paid out depends on the performance of PMCs and general financial market conditions. Payments may be higher or lower than total contributions. No one guarantees anything and the risk is borne solely by individuals (see note 50).\textsuperscript{54} Peter Staněk (2003: 54) of the SAS’s Institute of Slovak and World Economy warns that:

> the problem is the real state of pension funds in the European Union. At present, 92% of all pension funds are in a solvency crisis. Massive investment in technology stocks in 1995–1999 and the ensuing financial market crash led to a striking fall in real liquidity in an overwhelming majority of pension funds. This is confirmed by the OECD study on pension funds. The study states, for example, that there is an annual deficit in the financing of the PAYG system in Great Britain (this country also has a capitalisation pillar valued at over GBP 70 billion). This situation has arisen despite the control mechanisms designed to monitor the activities of European pension funds.

#### 4.2.2. Management risk

The last sentence in the quotation points to another risk to which we should direct our attention. The uncertainties of the reformed system are not confined to capital market fluctuations. Even in a favourable situation, a pension fund management can fail. It is true that the law lays down regulatory mechanisms for this case in Slovakia. However, it is also true that there have been noteworthy scandals in countries with much more effective regulatory mechanisms.\textsuperscript{55} For example, eleven investment banks, mainly from the USA,

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\textsuperscript{53} For example, the private ownership of a part of contributions prevents politicians from ‘dipping into’ pension funds.

\textsuperscript{54} The risk of capital market fluctuations was mentioned in the subsection on merit. To summarise, under a reformed DC scheme two people with identical earnings and contribution records may end up with very different pensions. The reason is that rates of return on financial markets change over time; whatever the current state of the market, in ten years’ time it could be very different. In consequence there is a real threat that two people with a ten year age difference, and hence also retirement age, will receive totally different pensions despite the fact that they contributed exactly the same amount of money to the pension system during their working lives.

\textsuperscript{55} The issue of underdevelopment of financial markets in the Central and East European countries is discussed in more detail by Wehlau (2003). The financial markets of these states are characterised by low capitalisation (the sum of accession countries’ market capitalisation together is broadly comparable to that of Ireland, which is the fourth-smallest stock market in absolute terms within the euro-area) and by insufficiently developed regulatory mechanisms. Investing in foreign capital markets might appear a way
were fined over USD 1.3 billion for manipulating research and information about corporate clients in order to retain lucrative banking business. The investment clients (those from pension funds and private clients) who were duped into following the investment advice, based on questionable intelligence about investment ratings, lost millions. The banks included Citibank, Merrill Lynch, Credit Suisse-First Boston and Goldman Sachs. The well-known Enron case is also relevant here, since it involved the placement of millions of dollars of employees’ pension funds in its own shares, which then became worthless due to its failed financial engineering. Similar cases can be documented also in Great Britain. Of the top ten pension fund management companies in the UK, four were fined USD 470 million, namely Merrill Lynch, Union Bank of Switzerland, Goldman Sachs and Deutsche Bank. Then there was the failure of major insurance companies, such as Equitable Life, to deliver on their promises to endowment holders and pension savers, unilaterally changing the rules of policy entitlement (Minns 2003).

As these examples show, regulatory mechanisms do not guarantee honest behaviour on the part of financial actors operating in the capitalisation pension system. Nevertheless, the Slovak government insists that its guarantees are adequate. Savings under the second pillar are governed by rules which supposedly provide for the highest pension level possible and will be subject to five stages of control, the government says. Concerning efforts to diminish the risk of misinvestment, the benchmarking method is important. If a shortfall its rate of return cannot be justified, a PMC will be obliged to pay the difference from its own assets. This is certainly an effective mechanism. Nonetheless, the danger remains that funds will ‘put all their eggs in one basket’, as in the abovementioned US case.

4.2.3. Risk of incomplete state guarantee

Last but not least, what happens if a PMC does not have sufficient funds to cover a shortfall or, notwithstanding regulatory mechanisms, misuses the savings in personal accounts. In such cases, the state guarantees the savings through the Social Insurance Agency. According to the Law on old-age pension savings, the SIA guarantees shortfalls in extenso but up to a maximum of 50% of its reserve fund. The court will decide on the indemnification level. Clearly, savers’ money is not deposited as safely as the MOLSAF publicity brochures assert; according to them, the state guarantees current savings in personal accounts up to 100%. This is another risk individuals might face. When circumstances are favourable (good capital market conditions, profitable investments), the PMCs gain while society neither wins nor loses. However, when a private company makes out of this situation. At this point, attention should be drawn to an interesting paradox – the Slovak government is trying to attract foreign investment by various breaks, but at the same time it has approved a reform that will cause capital efflux abroad.

56 These include the Financial Market Authority, auditors, the depository, internal PMC controls and the citizens themselves. However, only the first two stages can be considered relevant. The depository can only monitor whether the treatment of savings is in compliance with the law; it has nothing to do with the destination of investments or the level of returns. The internal control of a PMC is staffed by its employees, so their objectivity may be questionable. The ability of most citizens to monitor the performance of their PMC will be discussed later, although for now it can easily be imagined that it is insufficient.

57 In addition, one still has to bear in mind that we are discussing the management risk. The risk of capital market fluctuation is reduced only minimally (if ever) by the benchmarking method.

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a mistake, the consequences will be borne by the citizens. This is a practical outcome of neoliberalism: ‘privatisation of gains, socialisation of risk’.

4.2.4. Risk of old-age poverty

As already mentioned, under the reformed system there is no guaranteed minimum pension. However, the reluctance of the Slovak government to introduce such a minimum is not due only to a desire to motivate savers and avoid moral hazard. There is a strong suspicion that the government (quite justifiably) fears that the group of citizens eligible for a minimum pension would be large and this would significantly threaten the state budget. This holds especially for low-income groups, such as the unemployed, the disabled, and so on. According to Staněk (2003: 55–56), the wages of an ‘overwhelming majority’ of citizens are below the average wage level, and this is not likely to change markedly in the foreseeable future. The reason is that foreign investors relocate to countries with the lowest wages. Furthermore, over 70% of all citizens are wage earners. This means that low-income groups simply will not be able to save enough for their pension. The unemployed will be no better off. Staněk warns that the long-term trend of seeking to make firms more efficient will lead to workforce reductions of at least 10% in most firms. It should be mentioned here that the state will not pay contributions for the unemployed (nor for high school and university students) under any pillar of the reformed system.\textsuperscript{58} Clearly, socially vulnerable groups will have serious problems accumulating sufficient funds for retirement. This, combined with the lack of a minimum pension, represents a significant risk of old-age poverty in the future.

The feminisation of old-age poverty

After the reform, the risk of old-age poverty threatens women in particular. Pietruchová (2003) identifies several reasons. The first is that under the first and second pillars the pension benefit level will depend strictly on working life earnings. As women earn on average 26% less than men in Slovakia, their pensions will be lower. Another reason for lower women’s pensions is the fact that the parent taking parental leave is, of course, usually the mother. The state pays contributions for a parent on parental leave at the level of 60% of the average wage. Women’s contributions, hence also pensions, will therefore tend to be significantly lower than if they had not stopped working. Unpaid work – for example, child care and housework – although beneficial to the whole family, tends to be carried out by women. Men therefore have more time for paid work which will, of course, result in correspondingly higher pension contributions. Differences between the personal pension accounts of husbands and wives will be particularly detrimental for women and mothers in the case of divorce, Pietruchová concludes.\textsuperscript{59}

No protection against inflation

The risk of old-age poverty will be multiplied by the absence of mechanisms protecting against inflation under the second pillar. According to the current legal regulations, the calculation and paying out of old-age pensions under the second pillar does not take into

\textsuperscript{58} There exists an option in the new system to pay the insurance voluntarily or to pay it additionally after the period of studies or unemployment. However, the question remains: how many people, given the mentioned level of unemployment and wages, will be able to take advantage of this option?

\textsuperscript{59} The principle of division of assets is applied in several European countries. It consists in splitting the total sum accumulated during the duration of the marriage on the accounts of both partners into two equal halves.
4. Risks and social impacts of reform

account inflation or wage growth. Given the likelihood of rising inflation, the real purchasing power of pensions under the second pillar will fall. Pensions under the first pillar, however, are adjusted according to wage growth.

4.3. Questionable rate of return

However, not only the socially vulnerable groups mentioned in the previous section are at risk. In fact, all those who decide to save for their pensions under the second pillar are at risk. Government and PMC propaganda notwithstanding, there are reasons to believe that the replacement rate will keep on falling and that pensions from the second pillar will be no higher than PAYG pensions in the long run. This has been recognised even in some Slovak government documents that are not widely known to the public. According to the financial, economic, environmental and unemployment impacts clause of the Reform Concept (p. 14, Table 9), based on estimated real wage growth and asset gain, the old-age pension will be only 15% of wages, not the 40% often asserted by MOLSAF (Thomay 2003). The same conclusion has been drawn by the National Bank of Slovakia (NBS). The Law on old-age pension savings draft bill incorporated a restriction from the NBS stating that ‘the replacement rate in the capitalisation pillar will not be higher than in PAYG’.

Level of returns

One of the arguments presented by the Slovak government in support of the reform is that for decades investing in capital markets has been bringing higher real returns than those of the public PAYG scheme. The government claims that this trend is likely to continue in the future and should provide for higher pensions. However, as the following will aim to demonstrate, it is not so cut and dried.

The first question that arises in relation to rate of return is why stocks, which are just a claim on the present and future profits of the so-called real sector (corporations, and so on), should bring higher returns than the real sector itself. The answer is that stocks may have higher prices. In such a case, however, the stocks are overvalued. Such overvaluation is commonly estimated by means of the price-earnings (PE) ratio, which is the value of a company’s stock divided by its profits. Historically, in the USA, for example, the ratio averages about 14, but today it is about 20 (Krugman 2005). Therefore, it is true that investing in stocks can bring higher returns than PAYG. However, a number of experts doubt that the current trend can adequately guarantee that the rate of return from investing in stocks will continue to grow. In their view, stock overvaluation is a bubble that might easily burst. Henwood (1994), for example, considers it economically unwise to bet on financial asset prices indefinitely growing more rapidly than the value of the underlying real assets. This argument has its logic and is certainly in accordance with the conclusions of this paper. However, it is currently no more than a prognosis and awaits more detailed economic justification.

The lively debate currently ongoing in the USA can help us analyse future rate of return estimates. In his second term, it is a priority for President Bush to privatise Social Security (a franker term for what we call ‘pension reform’ in Slovakia) (VandeHei and Allen 2004). Despite the complexity of the issue, it will be helpful to sum up the basic points.

60 For example, the impacts clause of the Law on old-age pension savings draft bill expressly states: ‘in the long term, capitalisation brings higher returns than the PAYG system’.

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The Social Security Administration’s Office of the Actuary (OACT) has generally used a 7% real return on stocks (based on a long-term historical average) throughout its 75-year projection period. The real return on Treasury bonds is estimated at 3%. However, some critics say that these estimates are inconsistent with other estimates on the basis of which OACT projects the unsustainability of the PAYG system, namely the GDP growth rate projected as 1.5% for the 75-year period.\(^{61}\) Assuming an adjusted dividend yield of roughly 2.5% to 3% and projected GDP growth of 1.5%, the stock return implied by the so-called Gordon Formula\(^ {62}\) for stock return calculation is roughly 4% to 4.5%, not 7%! To make the equation work with a 7% stock return, assuming no change in projected GDP growth, would require an adjusted dividend yield of roughly 5.5% – about twice today’s level (Diamond 1999). If the OACT estimations are to be consistent, they must take into account either a higher growth rate or a lower rate of stock returns. DeLong (2005) introduces different options wherein the OACT estimates might be valid. The options qualified by the author as unlikely will not be mentioned. Assuming slow economic growth, equity returns could reach 6.5%\(^ {63}\) only in the case of a substantial decline in the stock market in the near future that would push dividend yields back up to the necessary levels (lower absolute values of returns will mean higher percentage values).\(^ {64}\)

To sum up what follows from this discussion in the Slovak context would lead to the conclusion that the pension reform proponents who assume the extrapolated continuation of the development of equity returns hitherto should recall their own ominous GDP growth rate estimate which serves as a basis for predicting the crisis of the PAYG system. If the equity returns have been high so far, it is due to faster GDP growth in the past. If economic growth is to slow down in the future, equity returns cannot be as high as they have been. However, if it does not slow down, the PAYG system should avoid the crisis and reform is not needed.\(^ {65}\)

Orszag (1999) offers another critical angle of comparison between the capitalisation and PAYG pillar rates of return. He says the returns cannot be compared seriously if the reform transition costs are not subtracted from the capitalisation pillar returns. In the case of Slovak pension reform, these costs are estimated at SKK 500 billion–1 trillion, depending on how many people decide to participate in the second pillar (Goliaš 2004b: 16). Redirecting half the contributions of those who decide to save in the second pillar to their personal accounts will create a deficit in the SIA. Any deficit affecting the pension benefits of those who remain exclusively in the first pillar will have to be made up by the state. The abovementioned SKK 500 billion–1 trillion will be used for this purpose. According to Orszag, this money can be borrowed by the government. However, the extra

\(^{61}\) Let us remember that a low GDP growth rate is projected also in Slovakia – 1.9% in the optimistic variant.

\(^{62}\) This formula says that stock returns equal the ratio of adjusted dividends to prices (or the adjusted dividend yield) plus the growth rate of stock prices.

\(^{63}\) DeLong uses slightly different parameters from Diamond – 1.9% for GDP growth rate and 6.5% for equity returns.

\(^{64}\) Diamond (1999) estimates that the capital markets would have to decline about 35–45% in real terms over the first decade of this century. In a similar line, Krugman (2005) points out that stocks are much more expensive than they used to be, relative to corporate profits (they are overvalued); that means lower dividends per dollar of share value.

returns would be clearly offset by interest payments in such a case. In any case, if the government borrows the money, it will have to repay it; if it does not borrow, it will have to cover the deficit directly from other sources. Wherever the money comes from – privatisation of state enterprises, government bonds, introduction of new taxes or spending cuts – in the end the reform will be paid for by the citizens, for the state does not have its ‘own’ money. Such measures are always at the expense of the working generation and, indeed, they work out the same as if the government had increased the contribution rate to the PAYG system (the only difference being that they are politically more feasible). Orszag says that the rate of return can, in fact, be higher in this case. However, it will not be the result of the reform, but of extra money infused into the system. The higher rate of return could equally be achieved in a maintained PAYG system if extra money were made available. Earlier it was mentioned that the historical decision to start paying out pension benefits to generations of people who had not contributed or had contributed very little to the pension system and so enjoyed super-normal rates of return. This is also the essence of Orszag’s argument: the decision was made and the ‘gift’ to the first generation needs to be repaid. Reform towards capitalisation does not permit us to renege on this. In this connection, Orszag (1999: 35) quotes Diamond to good effect:

[The reason the rate-of-return [for Social Security] remains below the market return is the presence of an unfunded liability ... current workers must receive a lower return from Social Security to pay for the higher returns received by earlier generations. The same analysis holds for individual accounts. The creation of individual accounts does not change the history that leaves Social Security with unfunded liabilities. The rate-of-return [under such a retirement system], including both individual accounts and the financing of the transition, is not increased by the creation of individual accounts per se.]

Administrative charges

The previous section demonstrated that, despite the government propaganda, it is unlikely that returns under the second pillar will be significantly higher than under PAYG. A fair comparison of rates of return in both systems also requires that their Administrative

66 With an interest rate of 10%, the return will be 10 cents on the dollar, but these 10 cents will be used for interest payments. The capitalisation pillar’s net return will thus be exactly the same as in a PAYG system: 0%. Orszag’s model is theoretical and to make calculations simpler, does not take into account GDP growth.

67 In Government decree No. 167 of 20 February 2002, the revenues from privatisation of the SGI amounting to approx. SKK 65–66 billion were approved for this purpose. Other revenues should come from the sale of Slovak Electric, remaining state shares in energy and telecommunications or other state enterprises. However, as Staněk (2003) points out, no more than SKK 150 billion in total can be expected from the privatisation of state enterprises. According to him, future economic recovery is also threatened by the deferral of worldwide economic recovery. In addition, if we include the reduced manoeuvrability imposed by the Maastricht indebtedness and state budget criteria, we can only express, together with Staněk, apprehension that the government will have nowhere from which to get the money to cover the SIA outage.

68 Orszag supports his conclusions with an analysis carried out by the Advisory Council on Social Security in 1994–1996. The members of the Advisory Council were unable to reach agreement on the role of individual accounts, so they split into three groups. The first group proposed a system similar to the Slovak one with almost half of contributions redirected to privately managed personal accounts; the second suggested that 1.6% of contributions be redirected to publicly managed personal accounts; and the third did not take on board personal accounts at all, proposing the investment of a portion of the Social Security Trust Fund reserves in the stock market. Despite the sharply different treatment of individual accounts in the three proposals, the rate of return of the first system was 2.6% and in the case of the third it was 2.2–2.7% (depending on the share of the Social Security Trust Fund invested in equities).
charges be considered. Experiences from abroad confirm that this is one of the most problematic issues of reform. In Chile, for example, such charges reached approximately 20% of contributions (for more details see Box 1). In the UK, the level of charges was even more alarming, climbing to 40–45% (Murthi, Orszag and Orszag 2001: 308). Slovak legislators appear not to have imposed such a high level of Administrative charges. Nonetheless, it will still be relatively high compared to the Administrative charges of a public PAYG system. The Slovak PMCs will charge for their services from the savers’ accumulated funds, at a rate of 1% of each contribution paid into the account, and up to a maximum 0.07–0.08% a month on total funds for account management. Although the numbers do not seem particularly high, PMC charges can represent as much as 15% of the total sum saved by workers. For example, take ‘Iveta’ from the MOLSAF publicity brochure (unemployed, age 25, born in 1980, started working in 2000, will retire in 2045, her average wage is SKK 15,000 in 2005, annual real wage growth is 2%, her period of unemployment represents 10% of her working life, she will have a husband of about the same age and no dependents when retiring, and the rate of return in Iveta’s personal account will be 3.5%) would save a total of SKK 1,445,495 and pay SKK 188,623.50 to her PMC in charges, which represents something over 13%. If ‘Iveta’ (or anyone else) did not join the second pillar and remained exclusively in the PAYG, she would pay at most 3% of her accumulated funds in Administrative charges (this upper limit for contributions to the reserve fund of the SIA is regulated by Law 461/2003 on social insurance, §168).

A charge for purchasing an annuity from a commercial insurance company is another item that will reduce the total sum of money saved. In the MOLSAF materials there is no mention of additional costs for savers when retiring and purchasing an annuity (which is quite unfair of the ministry). However, commercial insurance companies have to make a profit. The fact that there will be additional costs was confirmed in the author’s communications with the state authorities. According to the Financial Market Authority (FMA), ‘[T]he insurance companies include the initial (procurement) costs, standard administration costs, collection costs and pension payout costs in the annuity insurance calculation. The level of these costs, which influences the level of insurance, is not regulated’. The FMA will supervise whether the level is set correctly and lawfully (Financial Market Authority 2004). Besides the charges mentioned, so-called selection costs are also likely to reduce the sum of saved money. The annuity pensioners can buy with their lump sum depends on their life expectancy at the time they retire, as well as on the interest rate the insurance company expects to earn over the lifetime of the annuity. There is significant uncertainty about both variables. The life expectancy of the population can be extended, for example, in consequence of medical advances, and the interest rate is very sensitive to economic cycles (Barr 2000: 24). The insurance companies can resist any unfavourable developments by raising charges. They will be able to do the same in the case of losses caused by so-called adverse selection. In the context of the annuities market this term is used to describe the situation of people who expect to die younger or live

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69 Including charges for changing PMCs and for purchasing an annuity (see below).

70 It is necessary to add ‘so far’, because the level of charges can legally be changed at any time. It may turn out that the pension reform authors laid down comparatively lower charges in order to avoid criticism in the initial phase of the reform. At that time, there was a need to ensure credibility for the reform, leaving open as few opportunities as possible to oppose it. In a few years, the reform will almost certainly be irreversible and then it will also be possible to increase the level of charges.
longer than average and who, on the basis of this private information, choose a different type of annuity than might be available to them if the insurance company had the same information.\textsuperscript{71} If, in this situation, insurance companies paid annuities based on average life expectancy, they would lose out on people with longer than average life expectancy. Insurance companies consequently price annuities on the basis of longer life expectancies. A typical person of average life expectancy must therefore pay a higher price for an annuity than would be justified on the basis of average life expectancy (Murthi, Orszag a Orszag 2000: 4). It is difficult to estimate the level of costs connected to annuity purchase or the percentage share it would represent of the whole saved sum in Slovakia nowadays.\textsuperscript{72} However, it is certainly possible to say that there will be annuity purchase costs in the new system, whereas there are none under PAYG.

4.4. Flawed consumer information and risk of wrong choice

The section on the political-ideological grounds for pension reform mentioned that the pension reform authors cited freedom of choice as one of the virtues of the new system. It was also suggested that this freedom is illusory when we consider that citizens do not have enough information. According to a survey carried out by the agency GfK Slovakia in August 2004, only 6% of those surveyed thought the information provided on pension reform was sufficient. Fewer than one tenth of prospective savers could differentiate the first from the second pillar. More than half of those asked did not know whether they belonged to the group that will be allowed to choose to join the new system or not. Only a little more than one fifth of those surveyed knew that part of existing contributions would be redirected to the second pillar; almost one third supposed they would have to contribute more than before the reform; and 42% had no opinion (Apolen 2004: 4). Besides the lack of information, factors may emerge which even governments or the economically literate will be unable to predict, including the future development of the economy, financial market conditions, oil shocks, life expectancy, currency rates, pension fund decisions, and so on.

An individual hampered twice over (while on the one hand a given individual may lack the necessary knowledge to make an assessment, on the other hand there are many eventualities that cannot be predicted by anyone) with this kind of flawed information (or...)

\textsuperscript{71} In Slovakia, people who for some reason (serious illness, genetic inheritance, injury, and so on) know that they will live relatively short lives will probably choose programme withdrawal with a life annuity because they want to spend the saved money as soon as possible. However, adverse selection assumes asymmetric information: the insurance companies will know nothing of these personal life expectancy estimates of individual pensioners.

\textsuperscript{72} It would be possible to present recent examples from abroad by way of illustration. However, due to the lack of space and regarding the differences between the Slovak and other systems, and also concerning the future Slovak insurance industry development in this area (the first annuities will be paid out in ten years’ time), these comparisons would not be appropriate. For more detailed information for example from the United Kingdom see Finkelstein and Poterba (1999) or Murthi, Orszag and Orszag (2000). Yet an interesting fact pointed out by these authors merits some reflection. In another part of this paper it is stated that according to current regulations in Slovakia, pensions from the second pillar are not indexed, it does not mean it will be like that forever. Minister Kaník declared at a public meeting in Trnava, 28 February 2005, that there is still ten years for various minor adjustments to be made to the reform, for example, the valorisation of annuities. However, the abovementioned authors warn that charges for an inflation-indexed (real) annuity purchase are significantly higher than charges for purchasing a nominal annuity in the United Kingdom. It is, after all, understandable and raises the question why Slovakia should be an exception.
even ‘misinformation’) must choose his PMC and the right fund, assess its performance, approach the advertising propaganda critically, and perhaps decide to change PMC or fund. This is extremely difficult and there will always be the objective threat of making the wrong choice on the basis of flawed consumer information. What is presented as a freedom and a benefit (in fact, of course, it is neither) can thus pose a great risk.

Box 1: Risks and social impacts of the Chilean pension reform

The first country to reform its pension system in the way later advocated (in a moderated version) by the World Bank and followed by Slovakia was Chile. The introduction of pension reform in Chile in May 1981 was based on the economic programme presented under the name El Ladrillo (the block) elaborated by a group of economists from the Catholic University in Chile in 1970s (Kolesárová and Lendacký 2003: 5). Although the Chilean reform gets high marks for protecting the system from political risk and for its effects on capital accumulation and the functioning of the capital market, it gets low marks for the provision of insurance and for administration costs (Diamond 1993).

Pension insurance shortcomings. An estimated 40% of contributors, particularly women, are not expected to qualify for a minimum pension. They will thus be thrown onto public assistance at a level of income below the poverty line. This number could rise dramatically if the Chilean economy does not recover robust rates of growth (Scholte 2001). Savings are insufficient due to the low contribution rate (10% to the capitalisation pillar; there is no PAYG in Chile) and due to labour market conditions. People often shift between the formal and informal sector, which means a significant part of their income is not legal and so not acknowledged in order to avoid taxes and contributions. The informally employed, small entrepreneurs and tradesmen have the option to save voluntarily for their pensions, but their income often does not allow them to do much. For example, only 52% of those registered in the AFPs (similar to the Slovak PMCs) pay the contributions regularly. Those registered pay contributions for only about half their working lives. The rest of the time they are not able to save for their future pension. Those who did not contribute must make do with the so-called Pension Asistencial, a state mini-pension amounting to approximately USD 60 per month. If someone has contributed to a pension fund for at least twenty years, the state pays the difference between the saved amount and the minimum guaranteed pension (the latter is about USD 120 a month at present) (Topol 2004b). Despite the fact that Chile is definitely not among the poorest Latin American countries, there is a great risk of old-age poverty there. Apart from the pension system’s own shortcomings, this is caused to a great extent by the fact that Chile has among the highest income inequality in the world (Scholte 2001).

Administrative charges. The charges ‘lost’ by the saver in Chile to AFPs represent 17.7% of the total saved sum (Whitehouse 2000: 28). The charge for purchasing an annuity in a life insurance company represented 5.9% of the lump sum in Chile in 2000 (Kolesárová and Lendacký 2003: 16).

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73 For a brief survey of the Chilean reform and its impacts see Century Foundation (1998).
4.5. Summary

This section has focused on the risks of Slovak pension reform and its potential social impacts. The first threat identified was uncertainty. This may stem from capital market fluctuations, pension fund mismanagement, inadequate state guarantees or insufficient pension savings. The second risk is that the promised higher rate of returns in the capitalisation pillar is not assured and, what is more, unlikely. This conclusion is even more convincing when we consider the transition costs and Administrative charges. The inability of citizens to choose a PMC, monitor its performance and influence the level of returns is another risk. Finally, the section presented a brief overview of the risks and social impacts of probably the best known pension reform in the world in Chile.
5. Alternative pension scheme

The previous sections concentrated mostly on describing the pension scheme and criticising the reform measures. The aim of this section is to normatively define the basic principles any pension system should embody which seeks to maximise the public interest. The section will proceed on a slightly more abstract level than so far, skirting round the technical details somewhat. After defining each principle, we shall try to evaluate and compare its applicability in both PAYG and capitalisation systems.

5.1. Public interest criteria

It is not easy to define public interest criteria in the area of pension systems. As our discussion here is about preferences rather than objective facts, it may sound somewhat controversial. Our definition of public interest in this area is: individuals’ conceptions of how they want to fare in retirement, combined with the ability of society to implement them fairly for all. Of course, individual conceptions of retirement can vary. Nonetheless, ignoring concrete life-situations, most people would agree on a basic definition of their needs in old age.

The ability of different countries to manage the pension system, the principles they apply, the resources available for old-age pensions and how those resources are used vary. Despite all the difficulties, a number of general principles will be presented that should, in our view, be incorporated in every serious pension system.

Certainty of income

The first principle that should be reflected in a pension system is certainty. The purpose of old-age pensions is to secure an income during the period of one’s life when one is unlikely to be working any longer. In other words, it is to ensure certainty of income, to ensure that one’s standard of living does not fall below a certain level. It is essential for a pensioner that such assurance is guaranteed by law and that they are not wholly dependent on the good will of their family or on charity.

74 The author is grateful to Juraj Zamkovský, Roman Havlíček and Michal Polák for inspiring him to write this section.

75 Of course, it will be quite difficult to compare the systems because PAYG has existed in many countries, whereas the capitalisation system is a newcomer. Even in Chile it has operated, compared to standard pension schemes, for too short a time for us to assess its effects properly. In current pension reform debates, reform advocates often seem to be at an advantage when they start to compare existing systems, including their shortcomings, to non-existent, abstract systems. This paper aims to avoid this mistake and compare either theoretical PAYG to theoretical capitalisation models or practical PAYG to practical capitalisation systems (or its assumed development). There exist various forms and combinations of PAYG and capitalisation ways of financing pensions in both theory and reality. When comparing practical systems, the forms known from the Slovak environment will be used. Hence, under the PAYG system a publicly managed, defined benefit and pay-as-you-go financed scheme under the capitalisation system should be understood as a privately managed (publicly supervised), defined benefit and pre-funded system.

76 A similar approach in political philosophy was described by a prominent representative of modern contractualism, John Rawls (1971). Rawls describes a hypothetical ‘original state’ in which people have to agree on a fair organisation of society without knowing what their position in the social hierarchy will be. Rawls calls this limitation the ‘veil of ignorance’ (Blaha 2004: 34–47). The implication for us is that even if, say, PMC managers, right-wing ideologues, and so on, tend to prefer the capitalisation system in their concrete life-situation, under the veil of ignorance their preferences regarding an old-age pension system would probably be more similar to ours and indeed those of most people.
Before the formation of the first pension systems, old people were looked after by their family or charity. One can observe here on a small scale the principles that later constituted true pension systems. The children (extended family, church, state, and so on) ‘paid-as-they-went’ for the elderly from their current earnings. The principle remains transparent in modern pension systems: the active part of the population (working children) contributes part of their wage to the state budget, from which pensions for no-longer-active elderly (non-working parents) are paid. As already mentioned, PAYG pension systems are generally defined-benefit; that means that pensioners enjoy certainty concerning the level of their pension benefits.

The capitalisation system is based on investment returns that are uncertain. This system is accordingly only defined-contribution, not defined-benefit. Therefore, there is no certainty about the level of pension benefits, even from a theoretical point of view. The PAYG system gets higher marks in terms of certainty.

**Decent standard of living**

Pensioners also need a pension to provide a certain standard of living. First and foremost, pension income should ensure nourishing food, decent accommodation and adequate clothing. Although even these minimal conditions are not always ensured, one needs to go further. It is important not only for a pensioner to be secured economically, but also for that person to be able to continue to participate in public and cultural life. The pension should provide them with independence and dignity. Often pensioners feel sidelined, unvalued and stigmatised because of their age and relative poverty. Therefore, pensioners’ income should not be significantly lower than that of the rest of society. It is thus desirable to tie the level of pension benefits to the average wage in the economy.

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77 The principle that **all** pension systems are based on redistribution of the earnings of the active generation to the no-longer-active generation is illustrated in the Slovak folk fairy-tale ‘The Three Pennies’. Of the three pennies earned, one was for the parents, the second for the worker and the last penny to nurture the children. In modern society with its weak or completely absent traditional links, the state assumed responsibility for the elderly. Nonetheless, formation of the first modern pension system was not motivated altruistically; German Chancellor Bismarck established it to reduce the appeal to workers of the Social Democratic programme.

78 Of course, the certainty is never complete; anything can happen. Nonetheless, for my purposes, the highest degree of certainty will be a legal guarantee. Practical experience from countries with a PAYG system does not indicate fundamental problems, such as failures to pay the promised pensions.

79 The state guarantee of a minimum pension level can also exist in a capitalisation system (for instance in Chile). However, this still represents a PAYG component within a capitalisation system because the state pays out pensions from taxation.

80 This was discussed in more detail in the previous section.

81 Poverty is a relative term. For example, even if a pensioner owned a house and a car and had enough money for holidays and other luxuries, he might still be considered ‘poor’ if the society’s average was ten times higher. Destitution might be defined objectively, as it represents the minimal basic needs essential for survival. This applies to humankind in general. However, poverty is more of a social concept. This is also indicated by different perceptions of poverty in different cultures and circumstances. A pensioner who feels poor in Switzerland may have a higher real income than a pensioner considered rich in Slovakia. Likewise, a poor Slovak pensioner is well-off compared to an Indian greybeard. These international comparisons can also be applied within a single society.
5. Alternative pension scheme

It is not easy to evaluate the two systems under comparison in terms of decent living standards. Both are able to provide a decent livelihood in theory. The difference is that the capitalisation system differentiates between the generations (different returns at different times: one generation may do above average, another one below it) and between income groups (the link between level of contributions and pensions paid out: those with a higher income during working life have a higher standard of living in retirement, and vice versa). In reality, problems with securing a decent standard of living are common in both PAYG and capitalisation systems. However, this is often connected to other politico-economic factors. The ability to provide for a decent standard of living is thus about the same in both systems on average.\(^{82}\)

Decommodification and universal pension rights

Another important principle is that the level of pension benefit should not be dependent on the position occupied in the labour market by a pensioner during their working life, or on whether they worked at all or how much they earned.\(^{83}\) This is probably the most controversial demand, as the majority of people appear to believe that the level of pension should depend on activity during working life. Nevertheless, this position can be defended on the basis of the merit criterion. Whether a pensioner earned more or less during their working life, during retirement they do not work at all. Their ‘merit’ is thus the same in this period, amounting to zero in terms of material production. I am convinced that merit of this kind (consisting, for example, of time worked, effort expended, risk undergone, qualifications required, responsibility, and so on) should be rewarded exclusively during working life, not in retirement. If a prospective pensioner is interested in raising their living standards in retirement, they can do so by saving voluntarily. Etxezarreta (2003: 24) presents another reason for the decommodification of pensions and for shifting pension entitlement from work to citizenship. She says that increasingly less stable labour market arrangements and the resulting erosion of the traditional pension contribution base are a worldwide trend. Together with the abovementioned principle that pension benefits should be paid out on the basis of a person’s age and their inability to work rather than on the basis of working life ‘merit’, this is a sufficient reason to define the universal right to a pension as another principle of an ideal pension scheme.

It follows that this criterion can be better met in a PAYG system because the capitalisation system turns social security into a commodity available only to those who can afford to buy it.

Efficiency

The pension system’s efficiency is a very important criterion for both individuals and society as a whole. In addition to costs in the form of pension benefits, there must also be revenues to the system, and that is why it is important that their collection is effective. It would be ideal if all those obliged to do so always paid their contributions in full. A system ensuring the highest possible collection efficiency is therefore desirable.

\(^{82}\) In the case of low-income groups and generations hit by financial market crashes, the capitalisation system is obviously worse in terms of securing a decent standard of living. However, it is better in the opposite cases. Hence, on average it has the same impact as PAYG. The fact that it imposes risks on particular social groups can be seen as negative in terms of certainty and universality, but not in terms of securing a certain living standard.

\(^{83}\) This is the so-called decommodification principle and it was popularised by Gösta Esping-Andersen (1990).
For individuals, efficiency means that the smallest possible amount of their contributions is used for the administration of the system and connected costs. It is impossible to avoid such charges completely, of course, even in an extraordinarily effective system.

If one compares the capitalisation and the PAYG systems in terms of contribution collection efficiency, the former gets higher marks as the private ownership of part of the contributions will probably reduce the motivation of savers to avoid paying contributions. For individuals, however, the PAYG system is more effective because, as already mentioned, its Administrative charges are lower.

**Sustainability**

If a pension system has to be able to meet all the defined criteria over the long term it has to be sustainable. In general, sustainability has two dimensions: financial and political. Financial sustainability simply means that a society or a pension system is able to provide enough money to pay old-age pensions (which, of course, have to reach a certain level). One of the most important factors here is obviously economic performance. However, as it does not directly depend on the form of pension system, it will not be discussed here. Political sustainability implies that an ideal pension system must be generally accepted in society, be supported by all the parties involved (pensioners, workers, politicians, and so on), and that there be a nationwide consensus about it. To this end, the system should be the subject of active public debate. This is extremely important when introducing a new system. To ensure not only short-term, but also long-term acceptability of the system, the nationwide consensus must be built on solid foundations. This should be formed above all by objective information at least on its basic principles. Finally, in order to ensure a pension system’s financial and political sustainability, the level of pension benefits paid out (pensioners’ standard of living) should be tied to an adequate redistribution of economic output, that is to say, the wage level (workers’ standard of living).

In theory, both models are equally sustainable financially and politically as long as there is enough money for pensions and everyone is satisfied with them. However, it is difficult to find such ideal circumstances in practice. The PAYG system is perceived as financially unsustainable at present due to the growing number of pensioners for every worker. This ‘myth’ was discussed in the section on the grounds for reform. Briefly resuming the argument, while the pension reform does not solve pensioners’ problems, it will mean that increasingly pensioners will cease to be a concern of the state or a burden on the public budget. The capitalisation system would thus appear financially more sustainable. However, this is true only from the narrow perspective of the state. In a more complex perspective the pension system’s sustainability after the reform consists in little more than its partial abolition. The state risked failing to deliver on its promises and therefore it rewrote them, offloading responsibility and shifting the risk onto individuals. However, one should not consider sustainability as being something that can be isolated, since it is intrinsically linked to other provisions, including a decent pension level. Likewise, pensions mean more than the part administered by the state, namely a complex system of

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84 Regarding the projected population aging and population decrease, pensioners are likely to represent an increasingly high proportion of the population, and thus wield greater electoral power. It should therefore be stressed that if a pension system is to be politically sustainable, it must satisfy pensioners.

85 The term ‘myth’ as a label for false or dubious arguments in favour of pension reform was introduced by Orszag and Stiglitz (1999) and Barr (2000).
old-age income to ensure a decent level of pension benefit. That is why declaring that the financial sustainability of the capitalisation system is never better than that of a PAYG system or that its understanding is narrow-minded and simplified can be justified. After all, nothing is easier than ensuring the sustainability of a non-existent or minimal system.

Political sustainability also entails providing sufficient information on the pension system and satisfaction with it. The PAYG system suffered from political rather than financial unsustainability. The particular interests of specific actors were the real reasons for pension reform (discussed in a previous section) and also for the political unsustainability of the PAYG system. Mythologising its financial unsustainability and emphasising its shortcomings were intended to provoke public discontent. This goal was achieved due to the almost total control of (mis)information by the Slovak government and PMCs: discontent with the PAYG system started to grow. The same information channels were used to present the capitalisation pillar in a good light. However, its political sustainability will be revealed only in the course of time. The capitalisation system is certainly doing better at present. This manifests itself particularly in worldwide pressure in favour of reform, the disproportionate financial and media power of its advocates and the fact that it has not been around very long. However, assuming the author’s contentions about the effects of the capitalisation system (see Box 1 on the Chilean pension experiment) are correct, one might suppose that this sustainability is only temporary for the overwhelming majority of people.

Public control

Regardless of its form, every pension system should in the first instance serve its beneficiaries – present and future pensioners. There is surely no disputing this basic imperative. It can best be ensured in a system in which citizens can define their wishes, incorporate them in the system and supervise their implementation. The system must be transparent and resistant to corruption and ill-advised behaviour on the part of its administrators (politicians or managers). The greater the opportunities to control the system publicly, the better the system will be.

At the theoretical level, the PAYG system is better for ensuring public control because it is entirely publicly managed. In the capitalisation system, pensions are managed by private companies. Although their operation is also liable to public control, they do not have to answer for their internal affairs to the citizens. The instruments of this system – for example, the capital market – are scarcely subject to public control either.

In practice, of course, public control of PAYG systems leaves a lot to be desired. In a parliamentarian democracy, representatives elected by citizens are supposed to advocate their interests. However, this is often a wish rather than a reality and that also applies to pension systems. There are many examples of PAYG system shortcomings, as in the Chilean system which, before the reform, was disunited, chaotic and of little transparency (Kolesárová and Lendacký 2003: 6). The problems of the Slovak system before the reform were, for example: a pension benefit formula based on the best five years out of the last

86 It would be a topic for another paper to analyse the shortcomings of the present state of parliamentarian democracy, for example, citizens’ lack of opportunities or ability to influence public affairs, lack of interest, shortness of commitment, feelings of resignation or apathy, and so on. However, due to lack of space this issue will not be dealt with.
ten prior to claiming old age pension and the fact that the state did not use the SKK 12 billion reserve in the SIA to create, say, a sort of a demographic fund, but instead reduced social security payments to its insurees. The public interest was manifestly not being respected and public control mechanisms not utilised. Clearly, notwithstanding its greater theoretical potential, public control under a PAYG system can remain an idle opportunity. The capitalisation system faces the same problems, but in addition it is susceptible to corruption as its agents’ primary objective is profit.87 In sum, despite the PAYG system’s better prospects of ensuring public control in the area of pensions, the real likelihood of this is about the same in both systems. In practice, a capitalisation system might be envisaged whose public control would be better than in a PAYG, and vice versa. The particular nature of the two systems does not predetermine which one will be better at ensuring public control: that depends on the concrete public control mechanisms and the consistency of their implementation.

Table 4: Evaluation of public interest criteria application in pay-as-you-go and prefunded schemes

<table>
<thead>
<tr>
<th>Criterion</th>
<th>PAYG</th>
<th>Capitalisation system</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Certainty</td>
<td>+</td>
<td>–</td>
</tr>
<tr>
<td>2. Standard of living</td>
<td>Ø</td>
<td>Ø</td>
</tr>
<tr>
<td>3. Decommodification</td>
<td>+</td>
<td>–</td>
</tr>
<tr>
<td>4. Collection efficiency</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>Cost efficiency</td>
<td>+</td>
<td>–</td>
</tr>
<tr>
<td>5. Financial sustainability</td>
<td>Ø</td>
<td>Ø</td>
</tr>
<tr>
<td>Political sustainability</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>6. Public control in theory</td>
<td>+</td>
<td>–</td>
</tr>
<tr>
<td>Public control in practice</td>
<td>Ø</td>
<td>Ø</td>
</tr>
</tbody>
</table>

5.2. Basic features of the alternative pension scheme

As shown in Table 4, PAYG has tended to do better than the capitalisation system as regards public interest criteria. The latter has proved suitable only in the case of two out of six criteria.88 Therefore, PAYG has been chosen for designing the basic parameters of an alternative pension system. This might take the following form: (i) pensions financed from pay-as-you-go taxes (contributions to non-profit administration institution) whose amount might be about the same as the present one, say 30% of gross wages;89 (ii) equal real90

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87 It is important to mention here that the pension companies’ projected gains are extremely high. The prospective economic power of the PMCs is demonstrated also in the Reform Conception, according to which the assets of the second pillar will represent as much as 70% of GDP in 2085.

88 It is necessary to add that in the case of political sustainability, the capitalisation system won its plus sign only due to the present favourable circumstances and not because it would be more politically sustainable in principle. As we shall try to demonstrate in more detail in the next section, political sustainability can change in the course of time depending on the power of various interest groups within society.

89 Prospectively, the progressive contribution burden might be worth considering; people with a lower income would pay a lower rate than people with a higher income.
flat-rate pension benefits paid out to all citizens after reaching a certain age, say 65 years; (iii) the amount of pension benefits to be tied to the average wage in the economy (at least 75%); (iv) pension benefits indexed to average wage development; (v) voluntary supplementary pension insurance scheme for people who want to save more for their retirement; (vi) strong control mechanisms, transparent revenues and expenditures, efficient contribution collection body.

Although attainment of all these parameters might seem chimerical, there is one country whose pension system is quite close to my proposed alternative, New Zealand. The pension system there is pay-as-you-go, financed from general taxation. It is universal and provides relatively high flat-rate pension benefits – the rate of replacement is almost 65%. It is intended that pensions will be indexed to wage growth. The retirement age is being increased gradually to 65 years in New Zealand. In this country, there is also an option of pension insurance in a defined-contribution voluntary supplementary scheme (Barr 2000: 46).91

5.3. Summary

The aim of this section was to normatively define the basic criteria a pension system should meet in terms of the public interest. They include certainty, a decent standard of living, decommodification, efficiency, sustainability and public control. On this basis, I designed the basic parameters of an alternative pension system. On the example of the pension scheme in New Zealand, I demonstrated the feasibility of such a system.

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90 The level of benefits would obviously have to be different in various regions, averaged according to the price level. Pensions would thus be nominally different but a pensioner in any region could buy the same amount of goods and services for it.

91 In a referendum in September 1997, an overwhelming majority of citizens voted for the preservation of the existing pension system against a proposal to introduce a Chilean type system with mandatory saving on personal accounts. Turnout was a massive 80%, of whom 92% voted against the proposal.
6. Measures to improve the pension scheme

Throughout this paper, I have tried to sustain the argument that the troubles facing our PAYG system do not stem from its own character but from external forces. Any pension system would be equally susceptible to such problems, and therefore the Slovak reform does not represent a serious solution. However, it is not enough merely to assert this. Lack of money seems to be a common denominator. For this reason only measures which will increase the supply of money into the system can be deemed relevant.

Needless to say, the issue of pensions and pension reform is not neutral or abstract. The issue is political in the highest degree since it relates to what kind of society we want to live in. The answer to this question always depends on the power of the various interest groups. The following rule remains valid:

Neither the living standards of the currently active, nor those of the no-longer-active members of the population ever depend on this external form [of transfer of resources from the currently active to the no-longer-active]. They always depend only on (a) total economic output and (b) the rules of its redistribution between the two groups. The first parameter – the size of the total ‘pie’ – depends on available resources, technologies and efficiency; it is thus above all an economic issue. On the other hand, the rules that determine the redistribution of the total output between working and non-working people are a question of what power is available to enforce and defend demands; in other words, it is above all a political issue – whether this is apparent or not. (Polák 2004b: 2)

The following will look at methods for increasing economic output and redistributing it in a way that would enable a pension system to meet the public interest criteria defined in the previous section.92

6.1. Increasing economic output

The subsection on the shortcomings of demographic prognoses suggested that the projections of population aging and population decrease look adverse only ‘all things being equal’. If one includes other factors that are at least as important as demographic development for the condition of a pension system, the prognosis looks significantly different. Hence not pension reform, but rather a policy aimed at increasing economic output would represent the real solution.

There are basically two ways of attaining this goal: (i) increasing labour productivity and (ii) increasing the number of workers within each age cohort. Labour productivity, in turn, can be increased in two ways: (a) by investing in technological innovation and increasing aggregate capital equipment (in the sense of real capital, such as machinery), and (b) by increasing the quality of labour via investment in human capital. The number of workers can be increased by (c) aggregate demand–promoting policies that would result in full employment, (d) labour supply increasing policies that would create better conditions for

92 Considering the lack of space and the fact that the proposed measures do not directly relate to the topic of this paper, the recommendations will be succinct. However, that does not mean that, for example, the policies of increasing total economic output, decreasing unemployment, redistributing the fruits of labour etc. are not important. The reverse is true – these measures are extremely substantial also for the condition of a pension system. Nevertheless, they are complex enough to be the subject of another study.
becoming parents (support for house building, better child care facilities, tax policies which do not militate against part-time employment), (e) putting back the retirement age, (f) importing labour directly,93 and (g) importing labour indirectly by exporting capital to countries with a young population (Barr 2000: 33).

There is no doubting the importance of economic output. Persistent differences in national rates of productivity growth will have a far greater impact on future living standards than any other factor (Baker 2000: 15). According to Baker, the impact of variations in rates of productivity growth will on average be nearly four times as large as the higher projected tax burden associated with an aging population. Hence if the Slovak government wants to solve the problems (or projected problems) afflicting the pension system, it should – instead of costly and irrelevant reform94 – focus on improving the performance of the economy. The costs connected with pension reform could be used, for example, to invest in the purchase of advanced technologies from abroad, their application at home, supporting firms that pursue this policy themselves, and so on.

6.2. Redistributing the fruits of economic output

If the objective is to formulate measures that will make the pension system financially sound, it is not enough simply to ensure a total economic output increase. An essential related measure must be to ensure that the fruits of increased economic output are used effectively to improve the financial situation of the pension system. In other words, as many people as possible should participate in the system: that is, they should be employed and thus be able to pay contributions from their wages. The level of contribution must be set to cover the costs of pension benefit payouts and, at the same time, not to burden workers excessively. The following will consider ways of attaining these objectives.

Employment increase

Any increase in productivity would mean little for the pension system if it was attained alongside a low employment rate. We might imagine a hypothetical situation in which economic output is produced by machines owned by a small group of people employing the minimum number of workers required to operate the machines, leaving the overwhelming majority of the population jobless. The fruits of production would thus flow disproportionately to capital. In such a case (and similarly in a real situation of low employment), the

93 However, we must point out that policies (d) and (f) would be suitable in a country with no unemployment. In Slovakia, however, with an unemployment rate oscillating around 15% over the long term, it would not make much sense in terms of increasing economic output to support immigration or having more children. There would simply be no job vacancies.

94 It has already been demonstrated that the reform is irrelevant in terms of demography. However, several advocates of the reform argue that it can increase total economic output. Pensioners will save for their pensions – that should increase the savings rate – the savings should turn into investments – and the investments are alleged to raise productivity. However, this argument can be confuted. In the period of transition from one system to another, the total savings rate will increase exactly by the sum of costs used by the state to finance the deficit that is caused by the fact a part of workers’ money does not flow directly to pensioners but to personal accounts. The higher performance of the economy is thus a result of the money paid by the state. Whether the state has the money or is able to raise it is not related to the reform at all. In the period after the transition, the money saved by workers will be dissaved by pensioners. The reform will therefore not affect the savings rate and so not total economic output either. For a more detailed discussion see Orszag and Stiglitz (1999: 9–12), Barr (2000: 12–14) and Polák (2004b: 14–17).
6. Measures to improve the pension scheme

contribution flow to the pension system would be too low.\textsuperscript{95} This productivity increase for its own sake – or for maximising capital’s profit share – would probably result in higher unemployment rates; more efficient technologies would replace people.\textsuperscript{96} It is therefore necessary to keep in mind that, in terms of pension system solvency, retaining the highest employment rate possible is at least as important as a productivity increase.

Instead of pension reform, the Slovak government should focus on measures to increase the employment rate. According to official government documents it is making efforts in this direction. However, there are problems with the significance attached to this issue, methods for its solution and invested resources. According to the National Action Plan on Employment 2004–2006 (MOLSAF 2004: 12), the amount of financial resources available for active labour market policy will grow dynamically in 2005–2007. However, some experts say that the excessive emphasis on this is a mistake because the main types of active labour market policy and policy for increasing employment – activation, self-employment and re-qualification courses – implicitly presuppose a well functioning labour market that has sufficient jobs. Lack of motivation to find a job is often indicated as the main reason for unemployment, ignoring the lack of jobs in the economy (Kusá and Kvapilová 2004): the number of job applicants registered by labour offices in some regions of Slovakia exceeds the number of vacancies by ten to a hundred fold.\textsuperscript{97} Creating new jobs would thus seem to be the top priority solution to unemployment.\textsuperscript{98}

The government assumes a number of developments in the area of job creation, but these have also been criticised. The government has declared that employment will grow particularly as a consequence of foreign direct investment (FDI) attracted to Slovakia by various subsidies and tax holidays. However, the costs to the state of such investment incentives divided by the projected newly created jobs are often as much as ten times higher than the costs connected with creating or stabilising one job by means of a micro-credit (CEPA 2000). These micro-credits or micro-grants are issued under normal commercial conditions, they are recoverable – unlike state subsidies – and can be reinvested in the creation of more new jobs. Besides that, such jobs can be created in rural, economically-backward regions where the problem of unemployment is particularly severe.\textsuperscript{99}

\textsuperscript{95} This is a favourable situation for capital. As there are few employees, their ability to organise and demand a bigger portion of the gains in the form of higher wages will be low. In addition, capital can push wages down with the threat of lay-offs.

\textsuperscript{96} In economic theory, there is agreement that full employment does not generally represent the equilibrium state of capitalist economies; there are simply no vacancies for part of the population under the ‘natural’ operation of such economies.

\textsuperscript{97} According to data obtained from regional labour offices, the ratio of job applicants to vacancies was as follows in selected districts in June 2004: Banská Bystrica 21.5; Dunajská Streda 35.9; Galanta 7.6; Humenné 68; Kežmarok 153.7; Komárno 31; the Košice city districts together 30 (data for May 2004); Medzilaborce 91; Myjava 6.7; Nové Mesto n. V. 8.3; Nové Zámky and Šaľa together 33; Prešov 22.67; Revúca 54.6; Sabinov 20.5; Senica 14.6; Skalica 21.3; Šnina 336.2; and Stropkov 28.4.

\textsuperscript{98} The best way of ensuring more jobs is simply to create them directly. This, again, contravenes the neoliberal dogma which would say it is ‘artificial’ employment. Nevertheless, we must realise that such employment is ‘artificial’ only from the standpoint of the market and profit maximisation. However, if our aim is rather maximisation of society’s welfare, then there is nothing wrong at all with this classic instrument of Western social-democratic governments.

\textsuperscript{99} For a more detailed discussion of micro-financing see Kalafut (2001).
However, the most important aspect of employment growth policy is – as known since the 1930s – aggregate demand stimulation or state budget deficit financing (over the current level). Nevertheless, the present neoliberal Slovak government is at best unwilling to pursue this typical Keynesian policy.100

**Wages and contributions**

It would be a success in itself to reduce the unemployment rate to the lowest level possible, but one should go even further. The effect of this measure on the financial position of the pension system would be multiplied if wages grew, wage differentials diminished, or there were larger financial inflows from capital.

In pension reform debates, the option of raising the contribution rate to meet the growing demands of higher and higher numbers of pensioners is presented as utterly chimerical: the contribution burden is deemed very high already. However, these are not economic, but political assumptions. Of course, particularly in the Slovak context the wages of a significant part of the population are admittedly so low that a contribution rate increase would indeed be unbearable. Nevertheless, assuming higher wages, a higher rate of contributions to a pension system would not represent a cut in real disposable income: this could actually grow.101 Besides an economic output increase, wage growth in general can be influenced by how owners and employees participate in profits (redistribution between capital and labour). Wage growth among low-income groups can be positively affected by an overall levelling of wages (redistribution among workers). Existing output redistribution is always a political issue. The share of profits going to workers and income inequality will always depend on the power of different interest groups. The present overwhelming impression that redistribution is determined by some natural law or law of the market merely illustrates the neoliberals’ ability to impose such a perception on society.

However, the present dominant methods of redistribution should not be regarded as either natural or sacred and besides the abovementioned political measures (profit redistribution towards labour and a levelling of wages) additional methods for improving the pension system’s financial position will be presented. The abolition of the ceiling on contributions is the first. For example, the maximum assessment base for contributions is currently three times the average gross wage, despite the lack of any serious justification for a contribution ceiling. Next there is the option of progressive taxation, that is to say, higher-income groups would pay a higher social security contribution rate. A further option is to tax capital. This measure would in practice be equivalent to increasing the share of profits for labour at the expense of capital. Taxing capital may seem a radical measure at present but, again, only because of the contemporary power distribution in society. There are a

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100 It is true that with a small, open economy – as in the case of Slovakia – Keynesian instruments can be ineffective. The reason is that increased demand can be ‘discharged’ by increased imports which do not stimulate the domestic economy. It is also possible that, given the independence of the central bank, deficit fiscal policy would be compensated by a restrictive monetary policy on the part of the NBS. It would therefore be necessary to evaluate the practical impact of Keynesian measures. Nonetheless, not to consider them at all is surely not wise.

101 A model situation: If a person earns SKK 20,000 and the social security contribution rate is say 30%, the net income is SKK 14,000. If a person earns SKK 25,000 and the contribution rate is 35%, the net income is SKK 16,250. If one uses standard of living as a criterion, the situation with a higher contribution rate will be more favourable.
number of justifications for such a step. For example, Etxezarreta (2003:11) cannot see why the larger share of societal wealth demanded by pensioners should come entirely from the workers and not from the wealth of society as a whole, including capital. If wealth is the result of social activity, and the owners of capital benefit from its increase they should also participate in financing social expenses, the author insists.\footnote{This section discusses measures to sustain a PAYG scheme but several of them could and should be applied to all schemes. It would be a desirable application of the capital taxation principle in the Slovak reformed system if the PMCs started to contribute to the reserve fund from their profits. As the fund’s purpose is also to cover losses on personal accounts caused by PMC law breaking, the companies themselves – not only workers – should contribute to the fund as well. However, it would have to be specified that the PMCs pay from their \textit{own assets} and not from savers’ contributions, for in the latter case it would again be workers who ultimately pay.}

6.3. Improving contribution collection

One of the main problems facing any pension system in practice is that not all those obliged to contribute actually do so. This issue was outlined in section 3, which presented contribution payment default or contribution avoidance as one of the arguments put forward by pension reform advocates. Apart from straightforward illegal failure to pay contributions (so-called clear collection of contributions attained a rate of something over 94% in 2003) there is also semi-legal avoidance, for example, virtual tax base reduction or work in the black or grey economy. Section 5 evaluated the capitalisation system as preferable in these terms: the private ownership of part of contributions will probably reduce the motivation of some savers to contribution avoidance. However, this was one of the few comparative advantages of the capitalisation scheme. We shall therefore proceed to examine how to improve contribution collection under a PAYG scheme. A ‘soft’ approach might be an information campaign (perhaps supported by well known public figures and celebrities) which would appeal to the conscience of citizens to make them pay contributions willingly, for their own sake and for the sake of sustaining the pension system. We could observe similar activities in TV commercials encouraging people to pay concessionary charges (‘One to One!’) or in ads to promote buying original CDs (‘Burning Kills Music!’). However, the effectiveness of such campaigns is questionable. An altogether tougher method would be to extend the capacities and powers of the financial authorities to monitor and punish bad payers. Another method is a so-called ‘general amnesty’. This was advertised by the SIA as a sort of a ‘bargain’: within a certain period, bad payers were allowed to pay what they owed with no questions asked, and without being subject to penalty.

6.4. Increasing the fertility rate

If Slovakia really is hit by the projected demographic crisis, assuming full employment and disregarding the option of supporting immigration in order to compensate the lack of productive people, the only meaningful measure over the long term would be to promote the bearing of more children. The first component of the ‘demographic crisis’ – population aging (increasing life expectancy) – should not be regarded as a crisis at all, at least in the sense that it means that more people are living longer as distinct from an increase in the average age of the population. It is a positive trend indicating increasing quality of life. The second component – fewer children being born (natural population decrease) – is clearly an adverse trend, however, and so an area in which strong measures must be taken.
It is true that cultural changes in the post-communist region, including evolution of value preferences, such as attitudes to career, women’s emancipation, postponement of marriage, and so on, are to blame for the decreasing number of children. This trend has been observable in Western Europe over a longer time period and it is probable that Slovakia has started to ‘fall in line’. However, this is only part of the answer. Another important reason why fewer children are born in Slovakia now is that young potential parents do not feel that they have the means to establish a family. The likelihood is that if the government invested in, for example, housing programmes for young families, the fertility rate would rise almost immediately.

The demographic dependency ratio – the ratio of post-productive to productive people – is increasing in Slovakia. It is one of the main stated grounds for the pension reform. However, if we compared all non-productive people, including children, to the worker population (economic dependency ratio – the ratio of pre-productive and post-productive population components to the productive one), we would find that this trend was actually falling in Slovakia (Table 5). This means that active people have, on average, to provide for fewer non-productive people than in the past. Of course, the proportion of the two groups within the non-productive part of population has changed – there are fewer children and more elderly – but the overall burden is nevertheless lower. Under the PAYG system, this means that working parents ‘invest’ twice over. Together with childless workers, they provide for pensioners from their production (contributions) but, unlike the childless, they also provide for their own children, from whose future production (contributions) the parents as well as the childless of the foregoing generation will be provided for. As the childless do not have to take care of children during their lives, their income is higher. Therefore it might be worth considering the introduction of a principle in which the childless contribute more and parents (according to the number of children) less to a PAYG system.

<table>
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<tr>
<th>Table 5: Economic dependency ratio</th>
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<tr>
<td>Indicator</td>
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<tr>
<td>Founder</td>
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<tr>
<td>Economic dependency ratio (%)</td>
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Source: Statistical Office of the Slovak Republic.

6.5. Summary

This section focused on measures that would improve the PAYG system’s financial position. At the outset, it tried to make it clear that any pension system depends on total economic output and its redistribution. Redistribution is always of a political nature. Several potential ways of increasing economic output were sketched. In terms of redistributing the fruits of increased production favourably in relation to a pension system, it seemed desirable to increase the employment rate, to accelerate wage growth and levelling and to involve capital more in financing social costs. To conclude, measures likely to improve contribution collection and relevant measures to prevent demographic crisis were presented.

103 There is a similar measure in the Slovak reformed pension system. One of the employed parents (if there is both a father and a mother) can reduce their contributions by 0.5% for each dependent (up to a maximum of 8, or 4%).

Pension reform in Slovakia: the context of economic globalisation
7. Pension reform and welfare state retrenchment in post-communist Europe

The final section of this paper deals with the issue of pension reform more generally. The case of Slovak reform will be supplemented by a brief description of seven more CEE pension reform cases. On the example of pension reform, the aim is to provide a wider context and a possible explanatory framework for the influence of economic globalisation on post-Communist welfare states. More precisely, we shall seek plausible answers to the following questions: What kind of welfare do the CEE states provide; and, is it possible to define the trends charted by welfare states in the region?

It should be stated at the outset that it is no easy task to capture the reality of welfare state and social policies in CEE. Even after fifteen years of transition, these countries do not seem to have finalised the institutional framework;\(^\text{104}\) they are still developing and where they will end up is unknown. Moreover, obviously not all of them are heading in the same direction; even at first glance, it is possible to conclude intuitively that, despite similar historical legacies, they are not likely to form a single ‘welfare state family’. Furthermore, even at national level their social policies are often so diverse in character that it is impossible to categorise individual CEE welfare states using a uniform scheme. All this requires considerable further study.

This section will first present the classical (West European) typologies of the welfare state and of its retrenchment. It will then try to describe the starting point for study of current CEE welfare states: the Communist inheritance, as well as initial developments after the fall of the Iron Curtain. Part 3 will review the pension system (as the core welfare state programme) reforms in the eight new EU member states from CEE, thereby illustrating welfare state tendencies in the region. Lastly, the implications of the findings will be discussed and a number of hypotheses and explanatory frameworks will be put forward.

7.1. Classical typologies of the welfare state and welfare state retrenchment

There has been much more continuity in terms of welfare state development in the West than in CEE. Due to the relatively longer and more continuous time-scale, it has been possible to study welfare states in this part of the world more thoroughly and to categorise them into several clusters according to their differences. However, even the Western welfare states have faced crises and so have undergone several retrenchment initiatives. Again, the retrenchment differs from country to country.

The most famous welfare state typology is that of Gösta Esping-Andersen (1990). Following Esping-Andersen, Paul Pierson (2001) developed a typology of welfare state restructuring (reform, retrenchment, and so on depending on the vocabulary applied\(^\text{105}\)). This part will briefly introduce the main points of the two typologies. As indicated in the introduction, it is unlikely that the CEE welfare states would find a place in these

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\(^{104}\) Cerami (2005: 48) quotes institutionalists who say that transformation in Eastern Europe is still an ongoing process which does not allow for stable observable outcomes. According to them, path dependency theory might be helpful only once the ‘mode’ of transition has been concluded. This statement seems to hold for any theory.

\(^{105}\) These notions, although often used interchangeably, do not necessarily mean the same.
typologies. Nevertheless, they will be applied as a basic reference point in explaining the similarities and differences between and within CEE and Western welfare states.

Esping-Andersen’s seminal book *The Three Worlds of Welfare Capitalism* (1990) seeks to redefine welfare states. It criticises various comparative approaches (for example, according to social expenditure levels) and introduces another dimension of welfare state specification, namely social citizenship (legal guarantee of social rights), involving social stratification and the principle of decommodification.

Examining international variations in levels of decommodification and kinds of welfare state stratification Esping-Andersen distinguishes three ideal regime-types. The *liberal* welfare state, typical of the USA, Canada and Australia, provides the lowest level of decommodification and fosters social inequality. It is characterised by means-tested assistance, modest universal transfers (often associated with stigma) and modest social insurance plans. The *corporatist-conservative* welfare state type clusters for example Germany, Austria, Italy and France. It usually grants more social rights than its liberal counterpart but they are attached to class and status. This type encourages child bearing – social policy intervenes only when family cannot. The *social democratic* welfare state is typical of the Scandinavian countries. The levels of decommodification and social equality reach the highest level here. The social policies are rather universalistic and directly target children, the aged and the helpless (Esping-Andersen 1990: 26–29).

When studying the retrenchment of the welfare state, Pierson was puzzled by the lack of consensus on research outcomes concerning welfare state reform dynamics. He proposes that the retrenchment process can be properly understood in terms of three dimensions: recommodification, cost containment and recalibration. *Recommodification* implies a rollback of decommodification. It forces workers to accept less desirable jobs by tightening eligibility for welfare programmes or by cutting benefits. *Cost containment* means resistance to tax (or contributions) increases during a period of austerity. Finally, *recalibration* stands for reforms seeking to make welfare states more consistent with demands for social provision (Pierson 2001: 419–425).

Considering Esping-Andersen’s three ideal regime-types, Pierson (2001: 427) concludes that they generate different welfare state reform dynamics. He claims:

It has been in the liberal welfare states that a focus on re-commodification has been most pronounced. These already highly commodified welfare states have become more so – especially in [Great] Britain, New Zealand and the United States. By contrast, recalibration and cost containment have been more central to the policy agenda in Continental [corporatist-conservative] welfare states, while cost containment has been the principal issue in the social democratic welfare states of Scandinavia.

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106 More recently, scholars have developed a four-type classification: Scandinavian, Conservative Continental, Southern European and Anglo-Irish.

107 Esping-Andersen’s normative classification of social democratic, liberal, and corporatist-conservative regime-types is wittily illustrated by the title of Manow’s paper ‘The good, the bad, and the ugly’ (2004).
Both typologies have been criticised for a number of reasons. It is not the intention to defend them here, nor, as already mentioned, to claim they are directly applicable in the CEE context. The only reason for mentioning them here is that these typologies are probably the most widely accepted theoretical frameworks for the study of the welfare state and its reform. As such, they will help us to figure out and to define the position of welfare states in CEE.

7.2. Welfare state formation in CEE

It is now time to look at what the present post-Communist welfare states actually look like and where they are coming from. This part describes the welfare state’s Communist inheritance and its transformation in the course of the transition. As this section focuses on pension reforms as an example of welfare state retrenchment, particular attention will be paid to the development of pension systems in CEE.

It might be easiest to start with a hint at what the Communist welfare states were not. Keune (2006: 16) declares that ‘[d]uring the state-socialist era the welfare state was indeed substantially different from any of the EU-15, both in institutional terms and in outcomes’. According to Cerami (2005: 40), Communist welfare states provided free health care, full employment, housing, public pensions and a safety net for those unable to work. Full employment was particularly important – indeed, the obligation to work applied to practically everybody, with the exception of the disabled. Full employment also determined the form of social policies. Unemployment benefits were, naturally, non-existent; all welfare benefits were targeted at those who could not or had ceased to work, such as pensioners and the disabled.

If we consider only the universalistic and egalitarian appearance of the Communist welfare states, we might overlook a number of important facts. Full employment, as Keune (2006: 5) suggests, ‘was initially not an integral part of the state-socialist ideology … it emerged over time as a by-product of the rapid industrial growth and the resulting continuous demand for labour.’ Related to this, it should be stressed that it is difficult to talk about decommodification when people are forced to work. Lastly, the Communist welfare states were seen not only as excessive, but often also inefficient and characterised by shortages (Cerami 2005: 40). This type of welfare state thus does not fit easily into Esping-Andersen’s typology.

Regarding socialist pension systems, pension benefits were generally a mix of a flat-rate component and a percentage of the worker’s previous income (Dupont 2004: 57). Employers’ contributions were collected within the framework of the state budget; employees did not contribute. The link between contributions and benefits was usually

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108 For an overview of several points of criticism of Esping-Andersen’s typology, see, for example, Cerami (2005: 43–44).
109 Even Esping-Andersen (cit. in Polakowski 2005: 9) himself claimed that it would be problematic to apply his typology in CEE, as the latter is ‘a virtual laboratory of experimentation’.
110 Examples of other distinctive features of Communist welfare states are, according to Polakowski (2005: 10–11), state-operated channels of provision, subsidised prices on basic goods and services, and distribution at the level of production (rather than at the level of consumption, typical of the West).
111 Those refusing employment were labelled ‘parasites’ and risked jail.
weak – benefits were rather egalitarian. However, those having risky or unhealthy jobs were privileged by higher pension benefits (Guardiancich 2004: 43).

For all the CEE welfare states, the fall of Communism in 1989 proved to be a significant milestone. However, the welfare state institutions themselves, although perceived negatively by the new elites, were not the first things to go. Their reform was postponed to what Guardiancich (2004: 41) calls the ‘second wave’ of reforms. He asserts that the neoliberal strategy of stabilisation, liberalisation and privatisation were the priorities in the first wave. Nevertheless, even in the early 1990s, there were significant cuts in social expenditure. According to Vaughan-Whitehead (2003: 115), they were used to ensure a balanced budget, and to keep inflation, wages and exchange rates under control. He also mentions that these restrictive policies were carried out under the direct influence of international financial institutions.

The fact that the international financial institutions pursue their agenda worldwide has been remarked upon by many observers. More striking is the lack of influence of the institution which all CEE countries aspire to become members of, namely the European Union. Social policies in CEE have remained almost untouched by the EU. Deacon (cit. in Lendvai 2004: 321) echoes this as follows: the ‘countervailing political power of the EU vis-à-vis the [World] Bank is not as strong as it could be … this shortcoming was in part due to … the EU’s lack of clarity over what social policy it was selling.’ The EU’s comparative disadvantage thus seems to be a lack of consistency rather than a lack of leverage. As Lendvai (2004: 326) puts it, the problem is that the EU speaks two different languages: competitiveness on the one hand and Social Europe on the other.

CEE pension systems have followed the general pattern described in the previous paragraphs. As the requirements laid down by the acquis communautaire were minimal, CEE governments were free to design their own pension systems (Dupont 2004: 55). Pension system reform began to be debated in the mid-1990s, during the ‘second wave’ of welfare state restructuring. In the face of international influence and unfavourable demographic and economic prognoses, CEE governments started to consider both the introduction of private voluntary supplementary saving and parametric public pension system reforms, such as postponing the retirement age or cutting pension benefits. From 1998 on, the governments of some countries launched partial privatisation of their mandatory public pension schemes.

7.3. Pension reforms in the eight new EU member states from CEE

In the following section, we shall briefly review pension reform in the eight new EU member states to provide an example of welfare state retrenchment in CEE. Provision of pension benefits forms the core of the welfare state programme. It stands out because of the huge proportion of the public budget it represents, its long-term scope, its

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112 In 1994, the World Bank published its seminal and most influential (also widely criticised) publication on pension reform Averting the Old Age Crisis.
113 If not otherwise indicated, national data are obtained from the websites of ministries responsible for pensions. A broader overview of these countries can be found in Natali (2004a).
114 Pestoff (cit. in Manning 2004: 213) argues that it is better to classify social policy changes in CEE by service than by country. Classification of CEE welfare states by country would be desirable, but the option is currently unavailable.
inclusiveness, its complexity, and so on. The new EU members were chosen because the introduction of a mandatory private component into their pension systems represents an original choice within the EU, thus giving a new dimension to the so-called European social model.

Czech Republic

The Czech pension system is still PAYG, defined-benefit and universal. It has not introduced a mandatory private component yet and, so far, there is no reason to expect it. However, there have been efforts to link pensions to contributions. In 2004, parametric reforms were launched to prepare the system for a switch to NDC (expected around 2010). In the same year, the government appointed an expert committee to evaluate various pension reform scenarios. State-subsidised voluntary pension saving has been available since 1994 (Král 2004).

Estonia

In Estonia, a mandatory funded pension scheme was implemented in 2002. Out of the 33% social contribution rate, 20% is allocated for pensions. Of this amount, 4% flows to the funded pension scheme. An additional 2% is contributed to a fund by workers. Participation in the second pillar is mandatory for people born in 1983 or later. Participation rates have been fairly high: 55% of the population in the age group 18–60 opted for the private scheme. What is also specific about Estonia is the fact that the high increase in social tax revenues has been used to finance transition costs (Leppik 2004: 17). The option of voluntary saving has existed since 1998.

Hungary

Hungary was the first CEE country to launch a partial privatisation of its pension scheme, in 1998. The contribution rate to the second pillar is 8% out of a total of 26.5% gross-wage contributions to the pension system. Participation in the mixed system (both

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115 There are, of course, exceptions to this general rule. Sweden is the only ‘old-European’ country with a mandatory private pillar (although a relatively small one); and, as we shall see, the Czech Republic and Slovenia have not reformed their pension schemes radically.

116 For a detailed discussion of the link between EU enlargement and the European social model, see Vaughan-Whitehead (2003).

117 For a detailed description of the first decade of Czech pension reform, see Mácha (2002).

118 In an interview (Ondruš 2005), the Czech deputy minister of labour and social affairs Jiří Hofman declared: ‘We are not considering introducing mandatory private saving.’

119 Developed in Sweden, the Notional Defined Contribution system is pay-as-you-go financed but defined-contribution.


121 For a more detailed description of Estonian pension reform, see Leppik (2004).

122 Estonia is the only country in which workers contribute directly to private pension funds (Dupont 2004: 73). Their individual 2% contribution, together with the 4% contribution from the social tax, means that 6% of the gross wage flows into the private funded scheme.

123 For a detailed description of Hungarian pension reform, see Augusztinovics (2002). The overview draws on Natali (2004a).

124 Unavailability or divergence regarding contribution data means that these numbers have to be taken with caution.
public PAYG and private funded pillars) is mandatory for all newcomers to the labour market. Hungary, similar to the two previously mentioned countries, also has a so-called zero tier, representing means-tested benefits provided to people in need who do not have a sufficient contribution record. Voluntary saving has been in place since 1994.

**Latvia**

The pension system in Latvia was first reformed in 1996. The defined-benefit pension system was changed to NDC. It was partially privatised in 2001. The contribution rate to the second pillar is 2% but it will gradually increase – to 4% in 2007, 8% in 2008, 9% in 2009 and 10% in 2010. The total pension contribution rate is 27.10% of the gross wage. A Latvian peculiarity is that until January 2003, the sole asset manager was the State Treasury. Since then, participants have been allowed to choose between state or private state managers. Second pillar coverage is mandatory for those below thirty years of age in July 2001. The third, voluntary savings pillar has been available since 1998.

**Lithuania**

Lithuania is a relatively recent reformer. It introduced the second pillar only in 2004. Pension contributions represent 25% of earnings. The rate of contributions to the second pillar will rise by 1% every year – it started at 2.5% in 2004 – until it reaches 5.5% in 2007. It is interesting that participation in the second pillar is voluntary in Lithuania. The third pillar has existed since 2000.

**Poland**

The Poles overhauled their pension system completely in 1999. Similar to Latvia, they applied the NDC principle to their public scheme. At the same time, Poland created the second pillar with a 7.3% contribution rate out of total 19.52% pension contributions. Participation in the second pillar is mandatory for those born after 1968. The option of voluntary saving in private schemes was also introduced in 1999.

**Slovakia**

As already mentioned, Slovakia is the latest but at the same time probably the most radical reformer. Launching partial privatisation of the public pension scheme only in 2005, a full one-half of pension contributions have been diverted to the second pillar. Out of the total 28.75% allocated for pensions, 9% of old-age contributions flow to the funded scheme. Another 9% goes to the PAYG public scheme reformed in 2004, introducing earnings-related benefits. As in Latvia, there is no minimum pension guarantee. Participation in the reformed system is mandatory for all entering the labour market in 2005 or later. The third pillar was introduced in 1996.

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125 This Latvian pension reform overview draws on Vanovska (2004).
126 For more information, see Lazutka (2004).
127 For a detailed discussion of the Polish pension reform see Chlon-Dominczak (2002 and 2004). The overview here draws on both papers.
Slovenia

Slovenia is the second country without a mandatory private savings component in its pension system. The World Bank made strong efforts to push Slovenia into partial privatisation and they received some government support in 1998. However, only a parametric reform, tightening eligibility criteria, was introduced into the existing public scheme. High-risk workers are covered by a mandatory supplementary scheme financed exclusively by the employers. Voluntary saving under the third pillar has been an option since 2000.

7.4. Hypotheses concerning CEE welfare state pension trends

There are obviously a number of similarities and differences among the CEE pension reforms. In Latvia and Slovakia, for example, there is no guaranteed minimum pension. In Latvia and Poland, the reformed public pension systems have been individualised to some extent by the introduction of the NDC scheme. The Czech Republic plans to introduce it in the near future. Lithuania is the only country in which everyone can choose whether to participate in the privatised part of the pension system; in the remaining five countries that privatised part of their pension system, participation in pension saving is mandatory for people under a certain age.

These are all relatively minor variations, however. The most important difference is that two countries, namely the Czech Republic and Slovenia, have not introduced a mandatory private component into their pension schemes. Simplifying slightly, all the countries considered had similar legacies (a combination of pre-war Bismarckian and post-war Beveridgean pension systems), started their transformation at about the same time, faced the same international influences (the international financial institutions), and experienced some sort of economic and social hardship in the period of transformation. What can explain why only two of them stayed with their Bismarck-Beveridgean pension systems?

Before starting to discuss the Czech and Slovenian cases in order to describe the emergence of two major ‘clusters’ in CEE – pension ‘reformers’ and ‘non-reformers’ – it is helpful to look at some possible explanatory frameworks for pension reform divergence. The leverage of the international financial institutions in shaping pension reform policies is indeed strong. The World Bank’s *Averting the Old Age Crisis* (1994) proved to be extremely influential. The proposed multi-pillar design was adopted in six of the eight studied countries. The Bank’s role was either consultative – for example, former Bank member Rutkowski was directly involved in drawing up the Polish pension reform (Chlon-Dominczak 2002: 111) – and/or coercive (the Bank froze access to loans in Bulgaria and Poland because less reform-oriented governments were not implementing the reconstruction of the pension system as planned) (Cerami 2005: 74). Many government commitments to reform the pension system in accordance with the Bank model can be traced in the national CAS reports, as well as in national legislation.

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128 For a detailed description of the Slovenian rejection of privatisation and parametric reform of the public system, see Stanovnik (2002).

129 The World Bank was most influential in indebted countries.
Public perception of pension systems and proposed pension reforms is very important. According to Dupont (2004: 69), a complete overhaul of the pension system appears to be politically easier than tightening existing entitlement rules. The promise of a new, idealised and transparent system tends to prove very effective in a situation in which the existing pension system is not meeting citizens’ expectations. Given the doubts we have presented concerning whether people really will be better off under the new system, however, politicians’ advocacy of it must be suspect to say the least.

The role of labour in CEE is another factor which explains the adoption or rejection of the multi-pillar model. Avgadic (cit. in Lendvai 2004: 325) claims that ‘while social partners at the European level have virtually become legislators, the CEE social partners have been largely marginalized by their respective governments’. And indeed, trade unions in most cases had very little say in the legislative process that shaped pension systems in CEE. Moreover, the trade unions would by no means always have been opposed to mandatory private pension saving.

All the pension reform factors presented here seem to explain only those countries that have reformed their pension systems. However, the Czech Republic and Slovenia still somehow stand out. Other explanatory frameworks for divergence in pension system development are needed. Natali (2004b: 5–6) offers his thesis of hybridisation. He would not deny the impact of the international financial institutions, but he nonetheless thinks that the World Bank’s influence was filtered by past institutions and by systems adopted in other European countries. Natali claims, therefore, that the ‘new pension systems are the effect of the contamination of past programmes (inherited from the Communist era or even before) and institutions put in place in other European countries’. Guardiancich (2004) similarly rejects unidirectional explanations. Presenting the Polish and Slovenian pension reforms, he argues that both the path-dependency institutionalists and the convergence theorists were wrong. He proposes actor-centred institutionalism as the most suitable theoretical framework for studying CEE welfare state retrenchment because both countries’ reforms displayed path-dependent elements, while the political actors’ leeway was testified to by the fact that both radical and incremental scenarios were carefully considered in both cases.

7.5. Pension reform divergence: the Czech and Slovenian cases

We shall now examine the reasons for the Czech Republic and Slovenia’s exceptionality. The roles of international financial institutions, public perception of pension systems and

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130 For example, Chandler (cit. in Manning 2004: 221) argues that Latvia launched internationally prescribed pension reform as an open and public manifestation of independence from its Soviet past.
131 For an eloquent discussion of general labour weakness and ‘illusionary corporatism’ in CEE, see Ost (2000).
132 The Polish trade union Solidarnosc supported introduction of the second pillar (Chlon-Dominczak 2002: 110).
133 Most institutionalists expected the creation of corporatist-conservative welfare states in CEE because of the labour-based legacies and because of the strong West European influence. Convergence theorists, on the other hand, expected CEE would follow the World Bank’s recommendations and end up with a liberal welfare state. Guardiancich claims that the former failed to see the instability of the CEE institutions and the latter forgot that path-dependence plays a crucial role in inherited mature PAYG systems.
134 Potáček (2004) advocates a similar approach in explaining the social policy development in the Czech Republic, although he calls it ‘institutional and behavioural path-dependency’.
labour in the dismissal of radical pension reform proposals in these countries will be discussed.

The overall level of involvement of the international financial institutions in pension reform debates was relatively low in the Czech Republic and quite high but unsuccessful in Slovenia. In the former, the World Bank’s lack of leverage coincided with a low level of external debt. Moreover, 60% of this debt was contracted with private creditors, not with bilateral or multilateral agencies (Müller 2002: 117, 132). Furthermore, the relatively weak influence of the international financial institutions can be also explained by the fact that Czech Prime Minister Václav Klaus and influential liberal elites, whom one might have expected to support the introduction of neoliberal pension reform, were in fact against it, as the Bank’s model of mandatory saving was not liberal enough for them (Müller 2002: 133). Similar to the Czech Republic, Slovenia’s dependence on the international financial institutions was minimal. The share of contracts with private creditors was as much as 86% of the external debt in 2001. The World Bank classifies Slovenia as a high-income country, and it has not relied on significant assistance from the Bank. Nevertheless, the IMF and the Bank pushed for radical reform in the late 1990s in Slovenia by offering a loan and organising an international conference and workshop. These efforts were supported even by a number of high government officials, including Tone Rop, Minister of Labour, Family and Social Affairs, and Milan Vodopivec, a former World Bank official. However, after considering the financial costs, the Bank-style reform was rejected in 1998 (Müller 2002: 134.)

Compared to other CEE countries, negative perceptions of the existing public pension scheme were insignificant and the popularity of radical pension reform proposals was not high in either the Czech Republic or Slovenia. In the Czech Republic, supporters and opponents of radical pension reform formed almost equally big groups at the end of the 1990s (Mácha 2002: 107). During the period of pension reform debates in Slovenia, public support for reform fell, ‘probably because people became better informed and aware of its implications’ (Stanovnik 2002: 55).

The role of Czech and Slovenian labour was, again, exceptional in CEE. The Czech trade unions were able to raise public awareness regarding the pension reform issue. Despite their inability to veto laws and the absence of strong corporatist decision-making structures in the Czech Republic (Müller 2002: 133), the unions played an important role in the pension system policymaking process. The trade unions in Slovenia have been similarly strong. Their opposition to the introduction of mandatory pension saving took the form of the largest demonstration since independence. The mass protest meeting in March 1998 clearly indicated that there was a real threat of a general strike (Stanovnik 2002: 61).

Summing up briefly, CEE countries without a heavy burden of external debt, with a low level of public support for radical pension reform and with relatively strong labour movements are inclined to retain their public PAYG systems with only parametric

135 For an exciting account of the rejection of the radical pension reform advocated by the World Bank, see Stanovnik (2002).

136 We should mention here that neither in the Czech Republic nor in Slovenia was the population exposed to information campaigns aimed to popularise pension reform, unlike in countries whose government decided to reform the pension system. Such a decision was usually followed by huge advertising campaigns carried out by government and the pension funds.
changes. If we apply Pierson’s retrenchment typology to CEE pension reform, we can observe that the recommodifying component – that is, pension system privatisation – was absent in the Czech and Slovenian cases. These countries focused mainly on cost-containment: their major concern was the very high transition costs of a radical pension reform. A series of recalibrating measures – postponing the retirement age, abolition of some occupational privileges, the introduction and subsidising of supplementary voluntary savings, and so on – was also very important in the two countries. It would probably be wrong to classify the Czech Republic and Slovenia alongside the Continental welfare states, as the historical legacies discussed above are too different. However, at least in relation to pension system retrenchment, one can identify a clear tendency towards the Continental European mainstream in old-age security and against the ‘new pension orthodoxy’ (Müller 2002: 135).

7.6. Summary

In this section, the definition and classification of CEE welfare states was addressed. The classic Western typologies of welfare states and welfare state retrenchment were introduced. Then the historical legacy and the short transformation period of post-Communist welfare states, with particular focus on pension systems, were presented. Given the impossibility of classifying CEE welfare states by country and given the importance and core position of pension systems within welfare states, pensions were chosen as being representative of welfare state development in the region. The pension reforms in the eight new EU member states from CEE show that there have been divergent responses to the similar challenges faced by these countries’ pension systems. The major finding was that only two countries, the Czech Republic and Slovenia, decided not to privatise their pension systems. In the concluding part, possible theoretical explanations for this divergence were discussed. The basic conclusion is that in the presence of high external debt, strong public support for radical reforms and weak labour one can expect a drive towards liberal welfare state retrenchment strategies. In opposite circumstances, a move towards the Continental type of retrenchment is more likely.
8. Conclusion

This paper has proceeded gradually in examining the Slovak pension reform in the context of economic globalisation. After surveying the issue from a number of aspects, the main idea of the paper may have become obscure. Let us therefore repeat the hypothesis stated in the introduction: *The social security system reform in the Slovak Republic was not motivated by the unsustainability of the previous way of financing the pension system, as the approved reform measures generally do not solve the indicated problems. The officially stated reasoning for the need to reform the pension system is intended to draw attention away from the real reasons, thereby legitimising the reform in the eyes of the public. The real reasons are as follows: institutional investors’ efforts to expand financial markets through the inflow of previously public financial resources; pressure from the international financial institutions, particularly the World Bank; political efforts to implement the neoliberal notion of merit in the pension scheme; and the state’s effort to shift the risk of unfavourable developments onto individuals.*

The paper began by describing the pension scheme before and after the reform. There was a mandatory PAYG, defined-benefit social security system with a specific pension benefit formula in Slovakia before the reform. Mandatory contributions of up to 28% of the gross wage base of assessment, as well as a parallel pension pay out was administered by the statutory Social Insurance Agency. Men retired at the age of 60 and women at the average age of 55. Besides the dominant PAYG there was also a voluntary supplementary pension insurance system in Slovakia from 1997.

Since the reform the so-called three-pillar system has been in operation in Slovakia. As a matter of fact, the first pillar is a successor of the previous PAYG. The differences are: one half less contributions flowing into the system, postponed retirement age and a pension formula based on a link between contributions and benefits. The second pillar represents mandatory saving on personal accounts in pension management companies. Half the savers’ old-age contributions (9%) are directed into these accounts. PMCs invest the money to increase its value. The savers use the money on their accounts to buy a pension in a commercial life insurance company on retirement. The SIA continues to perform an important role, collecting contributions and administering the first pillar. The work of PMCs is inspected by the Financial Market Authority. The third pillar represents voluntary supplementary pension insurance. An amended law on supplementary pension insurance entered into force concurrently with the law on old-age pension savings.

Section 3 – the longest section of this paper – mapped the arguments for pension reform in Slovakia. Dividing these grounds into stated and real proved crucial. After scrutinising the argument on the unsustainability of the existing way of financing the pension system, it was concluded that the pension system’s regressive condition was not caused by intrinsic, but by external factors which, what is more, remain untouched after the reform. Unsustainability can be used as an argument only if based on long-term development prognoses. However, the shortcomings of these prognoses, together with the fact that the reform does not solve the problems even if the prognoses are fulfilled, lead us to the conclusion that unsustainability is just an artificial argument that veils the real reasons for reform, namely the ideological-political motivations of the Slovak pension reform authors, the influence of international financial institutions and an effort to expand capital markets.

Merit, justice, freedom of choice and motivation to pay contributions were identified as the main ideological motives. A more detailed analysis has shown that the neoliberal
interpretation of these criteria is reductionist. What is more, reform often brings outcomes that are inconsistent even with the neoliberal interpretation. The effort of the state to derogate responsibility for pensions is another ideological-political ground for reform. The view that the state should play a minimal role and that everybody should take care primarily of themselves is the ideological (in this case neoliberal) element of this. The political element consists in the efforts of politicians (of no matter what political orientation) to shift responsibility for prospective adverse demographic-economic developments to an automatic mechanism (that is, the market), and thus avoid a situation in which they have to make unpopular decisions.

The last part of section 3 focused on the involvement of international financial institutions in pension reform, as well as the endeavour of institutional investors to expand capital markets through the inflow of public finance. Intensifying efforts by the European Union to homogenise and consolidate its capital market to make it more competitive constituted the final ground for pension reform mentioned.

Section 4 focused on the risks of Slovak pension reform and its potential social impacts. The first threat identified was uncertainty. This may stem from capital market fluctuations, pension fund mismanagement, inadequate state guarantees or insufficient pension savings. The second risk consists of the fact that the higher rate of returns promised in the capitalisation pillar are not assured and, what is more, unlikely. This conclusion is even more convincing when we consider transition costs and Administrative charges. Citizens’ lack of competence to choose a PMC, monitor its performance and influence the level of returns is another risk. Finally, a brief overview of the risks and social impacts of probably the best known pension reform in the world, namely the one in Chile, was presented.

The aim of section 5 was to normatively define the basic criteria a pension system must meet in terms of the public interest. They include certainty, a decent standard of living, decommodification, efficiency, sustainability and public control. In these terms the basic parameters of an alternative pension system were laid down. With reference to the pension system in New Zealand, the feasibility of such a system was demonstrated.

Section 6 focused on measures that would improve the PAYG system’s financial position. To begin with, the section aimed to make it clear that any pension system depends on economic output and its redistribution. Redistribution is always political. Several potential ways of increasing economic output were sketched. In terms of redistributing the fruits of increased production to the advantage of the pension system, it was found desirable to increase the employment rate, accelerate wage growth and levelling, and involve capital in financing social costs. Lastly, measures to improve contribution collection exaction and measures to prevent the demographic crisis were presented.

The Slovak pension reform has been perceived quite positively among the citizens so far and little criticism has surfaced in the media. At the time of writing (January 2006), over one million people were participating in the second pillar, according to the available information. The pension reform authors can thus deem the reform successful. The aim of this paper has been, in contrast, to warn of the darker side of reform, its irrelevance and particularly its negative social impacts and risks. Compared to education and health care reforms, pension reform has one virtue (from the author’s point of view this is a handicap, of course): its negative impacts can be felt only after several decades when it will be hard to change anything. For the sake of future pensioners, the author hopes that his conclusions are wrong and his prognoses are not fulfilled in the future.
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