

# *Development Trends in Social Security with an Emphasis on Europe and Czechia*

## *Vývojové tendence sociálního zabezpečení se zaměřením na Evropu a Česko*

---

JAROSLAV VOSTATEK

---

The area of social security represents an intersection point of social, economic, and political interests. It has been the case for centuries and the social security will likely get more complicated and complex in the future. One of the theses hereof is the fact we should aim at resolving these issues in a comprehensive and systematic manner – preferably in the given country or uniformly in Europe, on the basis of a model. Easy to say, but hard to do – there are many strong economic and political interests in the world. Politicians and lobbyists tend to prefer partial solutions, which are beneficial for their careers. However, everybody will probably agree with our thesis concerning the need for a comprehensive solution on general basis, and it is up to us, theoreticians, to come up with the “correct” model solutions.

Europe has given the world the “Bismarck model” and the “Beveridge model”. The significance of these models lies in the fact they represent comprehensive social security systems, in spite of the fact the Bismarck model did not represent a solution for the majority of population at the time it was drawn up. But it had to start somewhere – mainly due to political reasons; however, financing of the system was critical as well. The Bismarck system has undergone many changes; however, it is remarkable that the basic frame remained, and the Bismarck model represents a fundamental social security alternative to this day. Not only is the Bismarckian “social insurance” still endorsed by Germany, Austria, and other prominent countries, following the failure of the communist systems, the model has been reapplied in many Eastern European countries, e.g. in Slovakia and Poland. Currently, Czechia is “surrounded” by countries with a social insurance. The social insurance has not won recognition in Czechia, even though many reforms were implemented, while many reforms have failed for various reasons. Before we talk about some of them in more detail, we will try to define social insurance as a social security model or method.

In the USA, the social insurance is perceived as a synonym for the government’s activity in the social area. We may come across an idea that the insurance provided by the government is marked as a “social insurance”, its purpose being the protection of people from poverty. In line with this concept, the main American social insurance program is the US “social security system”, which provides public pensions and health / disability provisions to the participants of the system (Act). According to this approach, other significant social insurance programs comprise the pension systems for federal public officials and soldiers, unemployment insurance, revenue and price support of farmers, and a number of support programs for war veterans (Tresch, 2008). Such interpretation of the term “social insurance” is very extensive; however, it is not associated with any specific construction of benefits and

social insurance premium payments so typical for the Bismarck model. Therefore, the views of certain American authors, who declared the social insurance to be a wrong income tax because it is not progressive, are not surprising. It is not useful to study the social insurance model from American textbooks; American authors are obviously not able to sufficiently free themselves from the American reality.

### **Bismarck model**

In the European / Bismarckian approach to the social insurance, two equivalent fundamental principles of the social insurance are applied – the principle of equivalency and the principle of social solidarity; these two principles are then taken to the totally crucial construction of the social insurance premium and pecuniary benefits. The social insurance was (and, in principle, is to this day) primarily intended for employees, i.e. not for all individuals or just poor individuals. The social insurance is not intended for rich individuals or employees. The specific classification of employees – fully covered by social insurance and others – is determined by an earnings ceiling, designated as a multiple of a nationwide average salary. The social insurance model targets employees below the earnings ceiling; this limit is best set at the amount between once or twice the nationwide average salary. Higher earnings ceilings do not make much sense from the model perspective. Originally, the earnings ceiling also served as the limit for inclusion in the statutory insurance system: the system was mandatory only for employees with salaries up to a certain amount. Today, however, the earnings ceiling serves this purpose only sporadically. On the other hand, the economic construction of the insurance premium and benefits has been intact.

The earnings ceiling is crucial both for the calculation of social insurance premium as well as for the calculation of pecuniary benefits; the identical limit is applied in both cases. That is the profound purpose of the social insurance and the equivalency principle. The insured pays insurance premium from a salary falling below the given earnings ceiling, and his/her benefits are calculated on the basis of the same earnings, up to the same earnings ceiling. The basis for my payments is the basis for my benefits. It is simple and fair. ("Fairness" served as the slogan for an implementation of the social pension insurance in Slovakia.) This principle may be applied at all points in countries with social insurance, even before a constitutional court. This was the case in Germany, and the approach was brought to the attention of the Czech population by the Constitutional Court judge Mrs. E. Wagnerová, when she considered it necessary to disavow the "not enough radical" ruling of our Constitutional Court in respect of the Act on the Public finance stabilization. The judge referred to the fact that the German Federal Constitutional Court had come to the conclusion that in case an insurance premium is collected from an employee's income (it concerned a "Christmas bonus" in the case under review), it is necessary to include this income in the salary, which is the basis for the calculation of benefits. The ruling of the German Constitutional Court complies with the social insurance model; however, it is not conclusive for us, because there is no social insurance system in place in our country.

The social insurance model comprises the sickness insurance branch, which, in its classic form, also includes health care as an in rem benefit. Originally, the significance of health care was only subsidiary within the social sickness insurance (especially from the financial point of view; however, the situation changed dramatically after the Second World War, and health care became crucial within the original classification of the social insurance (to the

detriment of pecuniary sickness benefits). This is only partially affected by an introduction of long guard periods (e.g. 6 weeks) for sickness benefits as the basic pecuniary benefits of the social sickness insurance – whereas during the first weeks, employees receive benefits from their employers, i.e. in the form of occupational provision.

Public health care – and thus also in the framework of the social insurance system – is dominated by the social solidarity principle. This somewhat modifies the whole modern social insurance model – and ever more so that public health care services in Europe were expanded to almost the entire population after the Second World War. In terms of social insurance systems, health care is not longer provided to employees only; it is also provided to retirees as former employees, to the insureds' family members (unless they are insured directly), self-employed, etc. Even the social sickness (health) insurance in Germany has recently been modified in this direction, whereas in this context, it is actually the “last” country from the group of countries firmly embedded within the social insurance system. However, it is becoming apparent that it does not have to necessarily prevent the comprehensive approach to the social security issues; social insurance continues to be the primary pillar of the system.

The significant application of the equivalency principle means that the (modern) social insurance system is associated with a relatively smaller extent of redistribution than the model liberal system. We refer to the intra-generation redistribution, whereas we do not consider the risk sharing within a group of clients typical for any insurance (insurance as such) to be income redistribution.

### **We do not have a social insurance**

Following our Velvet Revolution, the relevant ministry tried to introduce a social insurance system; however, it had failed, namely due to the significant liberal bias of the former cabinet. It is logical – classical and neoclassical liberals tend to prefer the Beveridge model, which provides universal benefits for the entire population. For the same scholarly political reasons, other elements of the social insurance model failed in Czechia as well. Today, the term social insurance is only used as a slang term (abbreviation) for the social security area in our country, where the “social security insurance premium and contribution for the state employment policy” apply. It does not apply to “health insurance”; on the other hand, the term “social and health insurance” is used as slang – this may partly be motivated by the need to express that our “public health insurance” is not part of the “social insurance”.

From the legal point of view, the factual existence of the social insurance can hardly be deduced from the mere application of the terms “insurance premium”, “pension insurance”, and “sickness insurance of employees”, or from the collocation “premium for pension insurance”, etc. Besides, the aforementioned “insurance premium” is just another form of the state budget revenue. Furthermore, the following legal provision: “The pension insurance premium shall be maintained within a separate state budget account and reported as a separate state budget revenue item” does not indicate that we should have a social insurance system in our country; the aforementioned provision was motivated by political schemes concerning the public pensions, including the schemes relating to the privatization of the pensions (in order to cover up the public deficit increase resulting from the privatization). In spite of this, our Constitutional Court overruled the guard period of 3 days relating to the

sickness insurance of employees introduced by the Act on the Public finance stabilization, on the grounds of an alleged infringement upon the right to adequate material security in case of an incapacity to work, since the obligation to pay insurance premium was not affected. Apparently, the Constitutional Court subconsciously based its deliberations on the presumption we actually have a social insurance system – i.e. that it is correct to apply the equivalency principle.

Certain constructions have been preserved within the Czech public pension system, which remind of the standard social pension insurance system. A pension is calculated from the personal basis of assessment, which is derived from the insured's earnings, taking into account the insured period. However, the personal basis of assessment fully includes the earnings up to the amount corresponding to 45% of the nationwide average salary; in the next "reduction" band of up to 115% of the nationwide average, only 30% of the earnings are used for the purpose of the calculation, while only 10% of the earnings are considered within the last band of up to 400% of the nationwide average salary. Such construction is miles off the social insurance model.

In addition to the aforementioned, we have a "basic pension assessment", which resulted from an integration of the "state compensatory contribution" within the public pension system, whereas the "state compensatory contribution" was introduced in 1990 as a general allowance for all citizens (it is actually a negative head tax), with the aim of partially compensating the negative impacts of the elimination of state subsidies for foodstuff and certain other products (elimination of the "negative turnover tax" – a rarity within the former system of centrally controlled retail prices). The "basic pension assessment" is actually a universal pension, which amounts to 9% of the nationwide average salary this year.

However, the social insurance model is completely different: there is "only" one earnings ceiling, e.g. at the amount of 200% of the nationwide average salary; in such case, the personal basis of assessment equals to the actual earnings of the insured ranging from 0 to 200% of the nationwide average. Any earnings of an insured person exceeding the limit of 200% shall be disregarded. It is plain and simple. This is the real beauty of a social insurance model. The model provides security to employees proportionally to their earnings, respecting the maximum salary ceiling. The specific amount of the security is given by political and economic decisions. It amounted to the subsistence minimum during the days of Bismarck, while today, it amounts up to 70% of the previous earnings in case of lifelong gainful activity. However, on a model basis, it may even amount to 100% of preretirement earnings, which is typical for the "(civil) service model" used in many countries to this day (and also for the European Union officials).

The characteristics of the existing Czech public pension system and its significant difference from the social insurance model are also documented by an OECD study. The so-called progressivity index is used here with a view to assess the extent of application of the equivalency principle; in case the value of 100% is assigned to a certain country, it means that the given country uses the Beveridge model – i.e. all citizens receive the same pension, irrespectively of their previous earnings. On the other hand, in case the value of 0% is assigned to a country, it means that only the equivalency principle is used for the given country, which is the typical attribute of a social insurance model (up to the earnings ceiling).

There are only a few countries with an universal pension as the only element of public pensions. In the aforementioned study, Czechia was assigned index of 69% and it was included in the group of countries with a “highly progressive” system (the index exceeds 65% – together with New Zealand and Ireland (both countries were assigned 100%), Australia, Great Britain and Canada. We are thus in the company of countries with the most liberal system. In this regard, we are quite unique in the region of Central and Eastern Europe. Slovakia was assigned the progressivity index of 1%, while Poland and Germany were assigned 3% and 24%, respectively.

The existing construction of pensions in Czechia, which is unambiguously dominated by the social solidarity principle (over the equivalency principle), results from the partial reforms of the system in the previous 20 years, including the implemented system of pension valorization, which provides a significant room for the government to apply a “sneaking” modification of the pension construction, e.g. by promoting the importance of the “basic pension assessment” of pensions. A major reform of the Czech public pension system has not taken place, and this is why no model is applied within the basic pension system in our country (either Bismarck or Beveridge model). Currently, no major pension reform is proposed by any of the important political parties. This may also be affected by the minimum supply on the part of Czech theoreticians.

### **Beveridge model**

The Beveridge model with its universal benefits and universal insurance premiums was established after the social insurance model. Furthermore, it was not established thanks to W. Beveridge in Great Britain in 1946 – 1948, but actually a few years earlier, since 1938 in New Zealand. It is a significantly more liberal concept, with a special construction. The modern concept of the pure liberal model does not include universal benefits, but only a social assistance as the (key) social security method. Nevertheless, when the retirement age is high enough (i.e. 65 – 70 years), it does not make any sense to examine whether persons over this artificial limit are disabled or not. This is the general concept of pensions, and it is also valid within the social insurance system at the time of its establishment. Let us suppose that analogical approach is also practical during the period of incapacity for work / disability of employees.

When the universal benefits are set below the subsistence minimum, we get the cheapest “modern” social security system, for the entire population. But why does the Beveridge model include a general “national insurance premium” paid by employees? It actually concerns a head tax paid by employees! Why should this tax be paid solely by employees and not by all individuals or residents? It is incorrect or at least controversial from the system point of view; a liberal system should include financing of universal benefits (moreover, at the social minimum amount) as a standard expenditure program, i.e. not by means of insurance premiums or any other specific tax.

However, the Beveridge system was formed the way it was – universal “national insurance” premium is a mirror image of the universal benefits of the “national insurance”. It makes as equal sense as when employees and employers share the social insurance premium costs equally (50:50) – this originated as a political compromise, and many politicians still believe that this should be a general characteristic of a social insurance system. However, it cannot be

supported by the economic theory. Besides, insurance premium payments were significantly simplified in many countries with a social insurance, as only one payer is sufficient.

The Beveridge model also includes a universal health care, organized in the form of one nationwide public network, identified as the National Health Service in Great Britain. The health service is outside of the “national insurance” scope; however, for some reason, it currently receives 15% of collected insurance premiums from the system.

It may be important to point out that the term “national” in Great Britain refers to “state” or “government” rather than to “national” in our (Czech) meaning of the word. It has been the common practice to translate the term “national insurance” as “národní pojištění”, so we will adhere to this. However, the British national insurance is not a social insurance system. And on the other hand: the Czechoslovak national insurance (since 1948) was a social insurance system, the last system of its kind within the territory of Czechia.

It will remain a historical fact that the Czech Cabinet led by V. Klaus practiced the policy of social expenditure damping in the past decade, which resulted in the social security system we have today. The social insurance model was rejected; however, for a long time, no model had been declared as a social reform objective. In terms of health care, there were attempts aimed at introducing plurality of health insurance companies and their products at first; however, the system of detailed central control was restored very quickly, namely due to fiscal reasons. No other system was available. The health care reform was then attempted by the Cabinet led by M. Topolánek; however, it was the beginning of its end. There were various discussions about the pension reform, and it is the key contribution of a government committee, and factually nonparty committee (the so-called Bezděk Committee), which not only prepared the prognosis of the existing public pension system, but also caused the parliament parties to specify their ideas on the pension reform. It is not the fault of the Bezděk Committee that no reform has actually taken place on the basis of its research.

With regard to the Beveridge model, it is interesting that approximately one year prior to the formation of the Bezděk Committee, V. Klaus declared for an introduction of universal pensions in our country. At that time, he was the Chairman of the Chamber of Deputies and his party (ODS) was the opposition party, preparing its “flat tax” concept and subsequently the “flat pension” concept. The pension reform proposal of ODS, targeting universal pensions at the amount of 20% of a nationwide average salary, was also tested by the Bezděk Committee. After the election stalemate, ODS – as the new leading government party – did not readdress the general pension concept, as it settled for parametrical modifications of the existing public pension system and only approved the concept of partial privatization of this system just before the end of its term (vote of no confidence). Today, the concept of universal pensions is endorsed by P. Mach and his political party, which is ideologically very close to V. Klaus.

Countries, in which the Beveridge model set in, experienced significant development of corporate/occupational provisory care as the second pension pillar. In principle, the following statement applies: the lower the level of public pensions (e.g. as a result of the Beveridge model application), the higher the need and room for the development of subsidiary pension systems. The corporate/occupational provisory care was originally a system based on the promotion of employees’ “loyalty” to “their” company; employees lost their (pension) ben-

efits upon leaving the company. The concept of the corporate/occupational provisory care has totally changed in the past decades, also due to activities of international organizations. Today, such pension benefits are typically “transferable” to a new employer or to the system of individual pension security. This is a fundamental conceptual change, which makes the pension security even more similar to the primary system. In some countries – e.g. in France, Switzerland, or in the Netherlands – this pension security has actually become part of the primary system. This is more or less the case in the (few) countries, which (still) maintain general pensions.

### Civil principle

Significant occupational schemes considerably modify the Beveridge system. In respect to our country, it is interesting that V. Klaus and ODS cabinets always stood out against the occupational schemes. This attitude corresponds to significantly liberal approaches: occupational schemes are associated with corporatism or collectivism. Furthermore, they also “spoil” the system of universal pensions, increase corporate expenditures, etc. On these grounds, the Cabinet of V. Klaus rejected this form of the standard 2nd pillar of the pension provision at the beginning of the past decade, and came up with a “civil” principle of the supplementary pension insurance, according to which a government may only support such insurance, which is concluded by a “citizen” – not by an employee or even an employer. As a result, state subsidies could also be drawn by retirees...

When applying the “civil” principle, employers may contribute to the supplementary pension insurance of their employees. Extreme liberals should probably refuse such “contributions” – however, with a reference to the current monopolization tendencies of the labor market (abroad), the government restricted certain pension benefits of mineworkers and similar professions in 1993-1994, and had to allow the provision of supplementary pension insurance contributions on the part of employers as a certain form of compensation.

Generally speaking, the “civil” principle is only a marketing support of purely individual insurance; however, it also has a general rational core. Individual insurance policies fit the modern approach to occupational schemes, which refuses the loss of pension rights when leaving an employer – it is the simplest arrangement, which, in principle, cannot be legislatively modified. On the other hand, the legislative arrangement of transferability of pension rights represents a modification of the basic construction of an insurance (or any other) contract, entered into by and between an employer and an insurance company (or by an employee if it does not concern insurance, but it concerns savings or pension promise). From this perspective, it is possible to explain introduction of personal pensions in Great Britain or the so-called Riester pensions in Germany. The preference of the 3rd pillar to the 2nd pillar (occupational schemes) has / may have this logic behind it.

However, in addition to possible legal reasons for the preference of an voluntary individual insurance to voluntary occupational scheme, it is also necessary to consider the economic aspect. This specifically concerns the costs of private insurance companies or other pension providers, associated with the provision of pensions – both in case of the occupational schemes and in case of individually arranged contracts with individual “citizens”. In general, it applies that the occupational schemes are considerably less expensive; however, these deliberations must always be based on the specific conditions in the given country.



Currently, the situation in Czechia is as follows: the product called supplementary pension insurance with a state contribution (it is a contribution-defined pension plan) has such high administrative costs that on long-term basis, it generates zero real revenues to clients and zero dividends to shareholders of the providers. At the same time, it is a product used by the majority of economically active population – and the reason is the high state support, which is not included in the aforementioned real revenues. This product actually has the highest state contributions in comparison with all other countries of the world. The high subsidies significantly deform the whole savings market. At the same time, the supplementary pension insurance with a state contribution has successful competition – the so-called buildings savings, a system, which only has a common name with building or housing. Both products represent blatant unfairness and market deformation, which would, for example in Germany, be remedied by the Constitutional Court – by annulling state contributions of both products. The most absurd fact is; however, that the “right” liberal would not provide state support to any product, let alone a financial product.

Therefore, we have a basic public pension (and not only pension) system, which is close to the Beveridge universal pension, and we also have a system of personal pensions with the highest subsidies in the world. It almost seems we would like to provide a maximum support to private pensions. At the same time, virtually nobody takes out personal pensions from this system, because clients have a capital option (to take advantage of a “one-off settlement” instead of a pension). The so-called Pension Directive of the EU, which regulates “institutions providing occupational retirement provision” with a view to create common market and to decrease the administrative costs, does not have any practical significance in our country – because occupational pension products do not receive any state support in Czechia. However, these institutions could bring pensions with lower administrative costs in comparison to those of the Czech so-called pension funds, which are – from the economic point of view – just specialized life insurance companies, not respecting the EU legislation on life insurance and life insurance companies.

### **Universalism of health care**

Today, the Beveridge model is basically a historical model, as it is only used in a significantly modified form, and in just a few developed countries. From the contemporary perspective, its most important component is the public health care system. A question is; however, to what extent the universal health care fits within the system of universal benefits. After all, there is a considerable difference between universal pensions at 15–25% of the nationwide average salary and health care, which was defined as a free health care for all citizens, which is to be the best and most modern health care (British White Paper of 1944). One way or another, the model of state (national) health care has survived and it is currently used in a number of countries – e.g. Great Britain, Sweden, Denmark ... and, in principle, in Czechia as well. The primary concept of our detailed central control of health care is close to the state health care system.

The public health care represents a very specific component of the social security. While the public pensions, for example, “only” concern money to a certain extent, health care also concerns services provided by doctors and medical facilities as well as medicines and other goods and services. Not only insurance companies (or other providers of financial services), but also doctors, pharmacists, hospitals, etc. have their interest and significant room to



enforce them. The basic fact is the ever accelerating development of medical options and medicines. The potential of health care is always ahead of the budgetary restrictions on the part of the government, population, and other entities. In this regard, we talk about “medical inflation” – and the spread is higher and higher, and this otherwise positive development of health care potential will definitely continue.

One of the key consequences induced by the medical inflation and longer lifespan consists in the universalism of health care. While it was virtually implied in the past that (universal) health care should be provided to each individual to full extent and quality (“complete health care for everyone”), today, the system is dominated by “new universalism”, according to which it is possible to provide only the basic care to everyone. In other words: in case health care is to be for everyone, it is not possible to provide all the services.

It is possible that we are going back, in a new form, to the “two-pillar” provision of health care – with the fact that all people or the majority of population may not “reach” the 2nd pillar care. Otherwise, however, the situation is comparable with other components of the social security – in respect of the pension security, for example, not everybody reaches the 2nd or even 3rd pillar, if only due to different preferences. It is possible to object that lives are at stake in case of health care; however, this has always been a case and, after all, some people have always had better position. During the times of leading role of the communist party, the party / government officials (some on the district level, too) had their SANOPZ – special health care system. Today, everybody can theoretically buy not only health care outside of the public health insurance system, but they can also pay extra for special or preferential health care in certain hospitals and other medical facilities. The offer also includes – outside of any insurance system – products of the so-called occupational preventive care, which receive tax benefits from the government.

However, the new universalism principally represents a new perspective in providing health care – it is not just the fact that “chosen ones” have always been advantaged. In principle, the quantity of the new health care supply has changed into new quality. At the same time, health care – similarly as other components of social security, public economics, and public expenditures – must be subject to regular analysis in respect of its relevant costs and benefits, and it is necessary to seek more effective solutions. At the same time, new information systems allow not only higher standards of client care, but also higher level of information provided to clients as well as more options and higher level of consumer protection. All this also brings new perspectives with regard to the status of health care participants, and new preferences. And it does not concern solely lives and health – it also concerns money. At the same time, the classic social security models are being modified, with completely new models being formed.

The new universalism has not been reflected to the relevant legislation yet, especially to constitutional laws. This also applies to Czechia, where the Charter of Fundamental Rights and Basic Freedoms (which is part of the constitutional regulation) states the following: “On the basis of public insurance, citizens are entitled to free health care and medical aids, under the statutory terms and conditions.” The term free health care creates problems for the construction of the health care financing systems, and it forces authors of the reforms to bypass this provision.

## Private insurance opt-out

At the beginning of 1980's, a new security model is being formed in Chile, which is characteristic by the fundamental emphasis on the mandatory private security. The pension / health provision reforms were part of the economic and social policy practiced by the Chilean military junta assisted by the "Chicago boys". The Chilean reform of the pension and health security was not motivated by the demographic developments in Chile, as the development was actually quite positive. The basic principle was a radical and complex privatization and maximum room for the market and competition. In 1981, the transformation of the social insurance system to the mandatory private pension insurance took place in the form of an opt-out – with the fact that the government provided all participants, who converted to the new system, with a bulk of insurance premium corresponding to the insurance premium paid to that date. Approximately 25% of existing insureds took advantage of the opt-out in the first month alone. The resulting budgetary deficit was financed by government loans, temporary taxation of salaries, privatization of state-owned enterprises, and previous surpluses of the state budget. Today, approximately 95% of employees take part in the system.

The Chilean system contains a number of motivational elements, e.g. after generating certain amount of funds on an individual account (enabling a pension at 50% of an individual's salary), there is no obligation to pay insurance premiums any more, and after reaching another, higher limit (with a pension at 70% of an individual's salary) it is possible to withdraw the surplus funds. Individual accounts are maintained by specialized private pension funds, which compete with each other and are subject to strict state regulation. Old-age security may be realized by purchasing pensions from a private insurance company, by withdrawing funds from an individual's pension fund account (programmed withdrawals), or by combining the two methods. The pension funds purchase disability and survivor insurance (as group insurance) from private insurance companies, charging the relevant fees to the participants (insurance premiums). The pension funds also charge a separate account administration fee to their clients, as a percentage of earnings.

In Chile, an insurance premium in the amount of 10% of earnings is intended for old-age security, and it is paid by the insured from his/her gross salary. Clients may also use this basic system in the form of a supplementary insurance – they may pay higher old-age pension insurance premium with the fact that this insurance premium is subject to the same tax mode as the mandatory pension insurance up to the amount of further 10% of gross salary. The supplementary insurance thus receives government tax support. Pensions are subject to an income tax.

The significant difference from the principally liberal Beveridge model as well as from the modern liberal social support model is apparent from the characteristics of the Chilean system of mandatory private pension insurance. Generally, employees receive pension security at the level approximately corresponding to what is customary in social insurance systems. In Chile, employees were promised that by saving 10% of their salaries – with a conservative 4% annual valuation – they will receive pensions at 70% of their salaries upon retiring, provided they would work throughout their life. At the same time, the specific amount of funds accumulated in pension funds significantly depends on the achieved return of resources allocated to individual funds.

The pension security has the nature of the product called funded (or financial) defined contribution pension scheme, or FDC in short. Investment risks are fully borne by clients with the fact that the government guarantees the minimum pension payout as well as 75% of claims exceeding this minimum.

J. Piñera, labeled as the “architect of the social security privatization” (he acted as the Chilean minister of labor and social security in 1978-1980), states in his paper of 2004 that:

- Average real annual return on the personal accounts of pension funds from inception are 10%;
- Pension funds accumulated resources equivalent to 70% of GDP, and these savings helped finance economic growth and spurred the development of liquid long-term domestic capital market;
- Pension reform contributed to doubling of the growth rate of the Chilean economy from 1985 to 1997 (from the historic 3 percent to 7.2 percent a year);
- Personal accounts have become the “third rail” of Chilean politics.

The critics of the Chilean pension reform point out the following deficiencies (Leiva 2005):

- High transformation costs and high public debt;
- Weak effective coverage of employees;
- High operational costs and management fees;
- High level of volatility and misleading rates of return;
- Discrimination against poor employees and namely women.

In 1981, Chile also introduced opt-out in the public health insurance – into the private insurance system. This private security is also operated by specialized private (health) insurance companies. The product offer comprises standard health insurance products with individualization according to (individual) risks and with the creation of technical reserves. Only the rich and healthy took advantage of the opt-out. In 1997, this form of insurance covered approximately 25% of the population, and only 15% used the opt-out in 2008.

The government does not regulate this private health insurance in any significant manner, and the insured may return from the private system to the public system. Due to the public system deficit caused by the departure of the best risks, the public system insurance premium increased significantly – from 4% to 7% of incomes. In 2005, the basic health care package was defined, which must also be provided by the private health insurance companies. In 2008, approximately 8% of the population lacked any form of insurance coverage. Europe would view the Chilean system of public and private health insurance as socially unfair and, as such, politically unbearable.

### **Mandatory private pension savings**

In 1994, the World Bank published its research report on the old-age security, which significantly affected pension reforms of many countries. In principle, it is based on the Chilean public pension reform, whereas it is aimed at promoting some other pension products and systems, too. The basic ideological frame is basically identical with the pension reform in Chile. It emphasizes macro- and microeconomic effects and influence of pension systems.

The research report contains a number of partial analyses, which are to document the need for a major reform.

The 1994 research report of the World Bank significantly enriched the pension theory and policy. Instead of public pensions and public sector, it offers, as a priority, mandatory private pensions and the regulation of private pension funds and other financial institutions. The offer does not apply to the World Bank as such (pension insurance of its employees), but to governments throughout the world, to which the World Bank provides advice and loans, which are usually subject to the execution of recommended reforms. The overall neoliberal approach to pensions represents analogy to approach to other areas with significant barriers for the free market system (e.g. the energy sector). All this is presented knowing that there are different conditions in different countries, and alternatives can therefore be considered.

While the social insurance model is built on two equivalently important basic principles – the equivalency principle and the social solidarity principle, the fundamental theoretical scheme of the 1994 World Bank report separates the two principles in two systems labeled as pillars:

- “Mandatory private pillar” is marked as the second pillar, and it operates exclusively under the equivalency principle – identified in the report as the “savings function”;
- “Public pillar” is identified as the first pillar, with the “redistribution function”.

According to the 1994 World Bank concept, the mandatory private pillar may be realized in two alternative forms: in the form of personal saving accounts and occupational plans; both alternatives require “rigorous regulation”. Personal saving accounts take precedence – with the exception of countries with existing extensive and functional occupational schemes.

According to this concept, the public pillar may be executed in any of the following forms: general social assistance system, guarantee of minimum pension within the second pillar (as is the case in Chile), or in the form of universal pensions or pensions depending on employment duration only. On general level, this pillar is also assigned other “insurance functions”: it should “coinsure” for the case of long-term low investment revenues, recession, inflation, and private market failures. The report does not contain any detailed specification of how to execute this “insurance function” of risks, which are uninsurable in the private sector. It can be interpreted that the government has to insure its citizens against the private pillar failure.

The role of the public pillar within the 1994 World Bank concept is significantly sidetracked, even though this pillar is identified as the first pillar. The existence of a general social assistance system, which is intended for the socially needy irrespectively of their age, is implied in all developed countries. In principle, the guaranteed minimum pension from the mandatory private insurance (or savings) system is part of an extensively defined social assistance system – and it is not necessary to discuss it separately. Therefore, we are left with the universal pensions, which are the core of the Beveridge model, and which are mainly provided in the World Bank concept as concession to the countries, which use these pensions.

The 1994 World Bank concept also envisages a third, voluntary private pillar. There is nothing specific on this matter.

It is also worth noting the thesis that the “insurance function” should be ensured by all three pillars – justified by the fact that “an extensive diversification is the best alternative to insurance against the very insecure world”. It can be seen as a starting point for the theory and policy of pillar diversification (with the motto “security through diversity”).

The key question of each pension system is assessment of specific amounts of pensions for individual clients and their valorization. The World Bank report only discusses these issues in one of its appendices (Issue Brief 10). Due to the known problems of private pension markets as such (predictability of longevity risk, inflation protection) and under the preference of the FDC system (volatility of returns, especially in the preretirement period), the issue is very difficult to resolve, even from the perspective of the World Bank; this is apparent in the statement that pension markets (sale of pensions) must be strictly regulated, as well as in the deliberation, whether these pensions should be mandatory at all – i.e. whether clients should be forced to buy their pensions. The final sentence of the appendix states that the best solution could be the combination of public pensions and private pensions (annuities); furthermore, retirees should be able to choose from annuities and other alternative benefits in case the given minimum is exceeded. The private pension security could thus end with public pensions. This explains the emphasis on the “savings function” in characterizing the mandatory private pillar as savings – and not as (pension) insurance. The model enforced by the World Bank at the end of the last century may be characterized, above all, as a mandatory private pension savings model, with following public or private pensions.

The macroeconomic dimension of the 1994 World Bank model is based on the presumption that the private pension insurance will lead to an increase in savings within an economy; the increased savings will induce growth of productive investments, which will be reflected in the (additional) economic growth. This dimension of the model is so crucial within the World Bank approach that it has been reflected in the title of the publication; the subtitle emphasizes (in bold) that it is about policies to protect the old and promote growth.

The World Bank report is characteristic by the boundless confidence in the effectiveness of the private sector in respect of old-age security, as it is immune to political interventions on the part of governments. At the same time, it envisages strong government regulation – as if the regulation is immune to political interventions and activities of lobbyists or relevant financial groups – private pension fund owners. The regulation also directly determines the maximum rates of fees, which would be deducted from the clients’ individual accounts.

One of the principal hypotheses of the mandatory private savings model is that the model will, on long-term basis, generate significantly higher valuation of clients’ assets in comparison to those, which would be accrued by governments or social pension insurance institution. Together with the considerably higher administrative costs of the competitive private system, it means that the returns from the financial allocation of private funds’ resources must be significantly higher than the revenues from government bonds. This is generally only possible with a significantly higher risk. In this situation, the volatility of financial revenues becomes crucial, as it also affects the overall value of individual pension funds’ portfolios and, consequently, the amount of paid out one-off benefits of the pension funds as well as the following pensions. This is no “pocket change”, but tens of percent in pensions.

The mandatory private pension savings model is based on a number of hypotheses, the legitimacy of which cannot be proven; in general, it is neither possible to prove the opposite. Similarly as in other cases, it is possible to find evidence or “proof” of everything in the world. This evidencing method is used quite frequently in the reviewed World Bank report. Finally, we should underline the question, whether the volatility of benefits is acceptable within the basic social security. I personally believe that it is not; generally speaking, it is the key issue of pension policy. Furthermore, we should probably recall that even the authors of the report are not sure, whether to allocate the payment of pensions from the basic pension security system to the private sector.

The mandatory private pension savings model leaves aside the security of disabled and survivors, which means, in fact, that it envisages a public social security system.

### **10 myths, diversification theory, and great circle of the World Bank**

At the time of publication of the World Bank report (1994), pension reforms were carried out in line with the Chilean example, more or less, in a number of other South American countries. The World Bank recommended the reforms based on its scenario to the countries of the former Soviet Bloc. This was the case in a number of countries, with a different level of the private sector involvement. When enforcing pension reforms in individual countries, the World Bank proceeded with more caution that could have resulted from the preceding presentation of the mandatory private pension savings model. The main reason consisted in high transformation costs associated with a conversion to the funded system – in this regard, the World Bank had to, willy-nilly, behave responsibly to certain extent; impact on the public finance, which would be induced by the single-shot privatization of public pensions according to the Chilean example, could not be endured by any European economy. It is also remarkable that the European Commission officially tolerates (ignores) public budget deficits induced by the pension system privatization when calculating deficit for the purpose of compliance with the Maastricht criteria.

In the course of the theoretical justification of the public budget deficits caused by the privatization of the social old-age security, its protagonists used the theory on implicit public pension debt. This implicit debt is a theoretical, artificial construction, which should express the volume of pension claims that should be met by the government in the future – subject to existing legislation. The implicit public pension debt construction is aimed at emphasizing that the government is actually strongly indebted – with the fact that existing pension claims are not “backed” by the existence of actuarial provisions created in line with the actuarial principles of the private pension insurance.

Many authors, who write about social reforms, do not know that the original Bismarck model worked with actuarial provisions similarly or identically as the private insurance does. In practice, these provisions (and not only these reserves) were literally destroyed by wars and hyperinflations. Following such events, the provisions were recreated. (The creation of these provisions in our country was last envisaged by Act on the national insurance of 1948; however, this approach was abolished at the beginning of the 1950's, because the creation of provisions did not make any sense under the new political-economic system.) Following the Second World War, pensions were significantly increased, together with the higher lifespan and lower retirement age, etc., which multiplied the need for actuarial provisions – even to

the extent these funds would play a major role on the capital market. For these reasons, the relevant countries (with a social insurance system) abandoned the funded system, which was originally assumed from the private insurance.

In general, it is possible to say that the social pension insurance system need not create provisions in the same manner the private insurance does. However, it may be (it is) meaningful to create these funds within social insurance system in order to deal with the fluctuations in pension payments and other benefits. However, such funds are incomparably lower than the standard actuarial provisions, which are generated for the reason of redeeming clients in case of a sudden termination of a private (life) insurance company's activities. This risk does not exist within a social insurance system, provided we abstract from wars and other similar events. This is why the concept of implicit public pension debit is "solely" a concept, which is to facilitate the position of privatizers of the social security system. It is actually a "dirty trick of academicians".

The mandatory private pension savings model, included in the 1994 World Bank research report and enforced by the WB in the course of its activities, stirred up various reactions. A number of national economists and journalists adopted the model and even improved it further. In our country, the then biggest supporters of the model included the trio of young macroeconomists O. Schneider, V. Kreidl and T. Jelinek. In their articles and presentations, they finalized the model in all aspects, concluding that – "mandatory private pillar" shall be the pillar no. 1, which is absolutely correct from the model perspective. Furthermore, they simulated the profitability of this model.

The model mainly provoked negative reactions of organizations engaged in social security, including the International Labor Organization.

A paper by P. R. Orszag and J. E. Stiglitz at the 1999 World Bank conference in Washington represented a significant reaction to the 1994 World Bank report. The conference theme was "New ideas about old age security", and the paper of the above mentioned authors had a concise title: "Rethinking pension reform: ten myths about social security systems". Simply said, the paper generally dishonored the "World Bank model", specifically its basic, mandatory private pillar, and – with its provocative presentation – significantly affected further analyses and pension policies as a whole. We should recall that Professor Stiglitz is, inter alia, a recipient of the Nobel Memorial Prize in Economic Sciences (2001) and the former Vice President of the World Bank. P. R. Orszag is currently a member of President Obama's administration. The above mentioned 10 myths relate to the research report of 1994; myths are classified in three groups: to macroeconomic, microeconomic, and political economic. Researchers, and subsequently politicians, could not ignore this paper – in case they were seriously dealing with the issue of pension system privatization after 1999.

In the following years, changes can be seen in the standpoints of the World Bank, which was clearing out its positions. The need for a "multi-pillar" is being stressed more and more, together with the effectiveness of (even a temporary) existence of a significant public pillar. This "evolution" resulted in the new World Bank report titled *Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform*, which was published in 2005 and prepared by a team led by R. Holzmann and R. Hinz. This report is free of



downright one-sided views of the private pension markets functioning and their regulation. It takes into account experiences with the enforcement of the mandatory private pension savings model. Instead of this mono-pillar model, the report formulates a “multi-pillar model”, consisting of (on general level) 5 pillars:

0. Non-contributory “zero pillar” is intended to do away with poverty – i.e. in principle, it has a social assistance or low universal benefit character (“demogrant” or “social pension”);
1. Mandatory “first pillar” should replace some portion of the lifetime pre-retirement income – it should be financed from earnings-related contributions, and it should typically be a pay-as-you-go system;
2. Mandatory “second pillar” typically represents an individual savings account (defined contribution plan), with a wide set of options relating to the product design, with benefits linked with risks resulting from the private asset management, high transaction and administrative costs, and also with the longevity risks, provided that benefit in the form of annuity is requested;
3. Voluntary “third pillar”, which is customized to individual needs of clients, and which may be in different forms – e.g. individual old-age, disability or death savings, occupational schemes; therefore, it is aimed at compensating the rigidity within the design of other pillars;
4. Non-financial “fourth pillar” comprises access to informal support (e.g. family support) or other formal social programs (e.g. health care and/or housing) and other individual financial and non-financial assets (such as home ownership or reverse mortgages).

The aforementioned sophisticated formulations have been taken over from the World Bank Pension Reform Primer and they are based on precise formulations, which should be suitable for various situations prevailing in individual countries, to which the World Bank provides assistance. Should we simplify the interpretation to European conditions, we could say the basis of this new concept is:

- Mandatory public pillar (e.g. in the form of social insurance); and
- Mandatory private pillar (identically with the 1994 concept).

At the same time, it is not said which of the pillars is the primary one – both are important, crucial. The significant difference from the 1994 model consists in the fact that the “basic” public pillar is in play again. The former first pillar became the “zero” pillar. The third and the fourth pillars represent supplementary pillars, which need not be addressed.

With some effort, this “multi-pillar model” may be regarded as a concept justifying the mix of public pensions and mandatory private pensions; according to this approach, both types of pensions have their pros and cons – and the optimum solution is to “combine” them in line with the specific conditions of the country in question. This is the theoretical basis for the pension reforms carried out in Poland and Slovakia; in Slovakia, they combined the two types in the rate of 1:1 (insurance premiums of 9% x 9%), while the combination rate amounted to 5:3 in Poland – all under the motto of Security through Diversity. However, some of the formulations of leaders of the World Bank team, which prepared the 2005 concept, signal that the basis of a modern pension system is a mandatory public pillar, and if

a country wants to privatize its public pension system, the World Bank would be happy to provide its advice, so that the local politicians avoid associated problems as much as possible. Naturally, this approach represents a major reversal – negation of the revolutionary ideas of the Chicago Boys, included in the 1994 concept. The key national economy maneuver included in the concept, generally promising an economic miracle as the product of public pension system privatization, is not discussed in the new concept. On the other hand, it is not possible to play down the microeconomic effects of various construction elements of individual products and pillars, they have their meaning and place in each modern deliberation on pension systems.

In conclusion of deliberations on models enforced by the World Bank, it is also possible to point out two different alternatives of the private pillar: In the original alternative (let us say Chilean alternative), clients are obliged to conclude a contract with one of the licensed, specialized pension funds. In this alternative, pension funds compete for clients, and the relevant financial groups also use their client databases to offer their other products.

The second alternative, which was applied in Sweden, for example, consists in the fact that a client selects (maximally) one of the more or less risky products, and based on this selection, the relevant public authority allocates assets to its selected investment companies – the reason being considerably lower administrative and management costs (fees). Generally speaking, this alternative is far less interesting for the private sector.

With regard to the supporters of the theory on the major national economic manoeuvre associated with the public pension privatization, it is possible to draw up another (third) investment variant (alternative): not only will this alternative do without the collection of insurance premiums and the whole pension savings agenda on the level of individual pension funds (as the second alternative), but it will also get by the link of the state-invested financial funds to the existing (any) pension system. A government shall take a bulk of money from the state budget and remits it to a selected financial group (or groups) to allocate it on financial markets – it will reach significant returns for the state budget. The government may even borrow money for this financial manoeuvre – after all, it would have to borrow substantial funds in case of a privatization. If we do this on the necessary scale, it will not be necessary to even pay taxes in time; instead, we will borrow money (cheaply) and invest the borrowed money (with higher revenues) in private investment funds. Naturally, this is an attempted joke; nevertheless, the public pension privatizations are similarly profitable manoeuvre: governments will borrow money so that it could invest the borrowed money in private funds.

### **Modern social pension insurance: NDC**

At the end of the last century, a new alternative of the social insurance model (in the area of old-age pensions) was formed in Sweden, Latvia, Italy, and Poland. It is the NDC system, which originally was the abbreviation of the term notional DC (DC = defined-contribution), which; however, more and more refers to non-financial DC, i.e. non-financial defined-contribution system. In this system, old-age pensions are calculated from the individual account balance, using the standard actuarial appliances (pension for single premium). The insured's individual account is credited with the insurance premiums by the insured (or his/her employer). The insurance premium shall be assessed in the same manner as in the "standard" social insurance model – i.e. on the basis of income, up to an earnings ceiling. Unlike the private

pension insurance, the NDC system does not create any actuarial provisions – hence the adjective non-financial or notional.

The key contribution of the NDC system is its flexibility in respect of the demographic development, automatic reaction to population aging – without the need of political interventions in the form of amendments to various acts. Similarly as any other public / private pension system, even the NDC system is not immune to political interventions. The flexibility, simplicity, and transparency of the whole system are also important.

The standard social insurance model is a the so-called defined-benefit system (DB), containing “strict” old-age threshold and “strict” condition of minimum insured period (which has been extended throughout the long-term existence of the social insurance, thus becoming more and more important); upon the fulfillment of the defined criteria, a person was entitled to a pension on the basis of the following formula: “personal basis of assessment” multiplied by the number of insured years and ratio assessing each year of insurance period. This was (later) completed with various surcharges and bonuses for late / early retirement. All these parameters could be modified in practice, on the basis of volitional deliberations. This is how the social pension insurance system originated. We may also recall that old-age pensions were originally a special form of disability pensions (where it was not necessary to check the disability). Today, old-age pensions dominate the pension systems from the perspective of expenditures.

Last but not least, it is important that contribution-defined systems have only arisen and developed (within the private personal insurance) in the past decades. The key motivation for the formation of defined contribution (DC) systems was the reduction of actuarial risk, i.e. transfer of the (whole) investment risk to clients of private insurance companies. This has also led to higher dynamics of the private personal insurance throughout the world. New branches of life insurance are being formed on the basis of clients’ individual accounts – such as universal life insurance and variable universal life / unit-linked insurance. The defined-contribution product, which is commonly offered by pension funds in the USA, is actually a universal or unit-linked insurance, narrowed down to savings (investments) within an individual account. It is actually a bank / investment product, which may be offered as an insurance coverage (e.g. in our country). I point out that the defined-contribution insurance schemes in the USA normally end with a one-off payment of the accumulated funds; a pension is not part of these products.

Naturally, the NDC system did not originate to transfer investment risks to clients. However, it is a mechanism, which can more easily react to demographic changes, i.e. it concerns a transfer of the demographic risk (longevity risk) to clients. This possible use of the NDC system is very important from the practical point of view; however, the construction of the system is neutral. The system may be used under any demographic conditions.

In principle, the NDC system may be set up in such manner that it is not necessary to change its parameters in medium-term horizon. However, it requires superior preparation of a pension reform; it is not possible to have a government proposal, which is subsequently significantly (as for parameters) modified by the parliament, as was the case in Czechia in mid-1990’s.

Even though the NDC system is fairly young and its qualities are still to be tested in practice, the World Bank held a conference in 2003 on the Swedish island Sandhamn, dedicated to the potential application of the NDC system within the European Union. On the basis of papers presented at the conference, and upon the completion by other written materials, the World Bank released an extensive publication in 2006 (edited by R. Holzmann and E. Palmer) on pension reforms in the EU, in which it recommends that the EU focuses on the three-pillar system, with an NDC system at the core, supplemented with private pensions and social pensions. Such system would meet “all generic and EU-specific demands on a Pan-European pension system, including the room for national preferences” (R. Holzmann). Efforts at the all-European system (EU) are meaningful in respect to the continuing economic integration of the EU; it should replace the not so effective “open coordination method” used in other areas of activities within the EU.

The “social pensions” are included in the “social pillar”. In the Holzmann’s concept, this pillar is not a mere “zero pillar” (as within the multi-pillar model of the World Bank). This pillar, which currently comprises all “noncontributory” pensions in the form of general social assistance system or special social assistance system for elderly, or in the form of an universal pension (demogrant), should be more important within the Pan-European model than it is today, in average. The reason for this is the relation to the basic NDC system, which is to be built significantly on the equivalency principle. The institute of minimum pensions and other similar instruments should be moved from the primary pillar (newly NDC) to the social pillar.

Private pensions are also very important within the Pan-European model, generally comparable with the social pillar. Therefore, R. Holzmann characterizes this pillar as the “second or third” pillar of the system. It requires that the basic system (NDC) does not provide generous compensations, in order to ensure “consumption smoothing” in excess of the NDC benefits, and also to promote flexibility upon retirement, risk diversification, and support of mobility within the EU. For these rather general reasons, he prefers private pensions to supplementary insurance within the NDC. (Holzmann, Palmer 2006)

Four member states of the EU have already implemented the NDC system (find the year of act adoption / year of effectiveness in parenthesis):

- Sweden (1994/1999)
- Italy and Latvia (1995/1996)
- Poland (1998/1999)

At the same time, Italy and Sweden are implementing the NDC system gradually, for several decades. On the other hand, Latvia implemented the system immediately for all the insureds. According to R. Holzmann, only the Latvian method is suitable – in order to ensure the work-force mobility, which is the primary goal of the proposed Pan-European reform. Germany, France (and Slovakia – JV) have the so-called point social insurance system, which is close to the NDC system; this means that a conversion to the NDC system would be simple in these countries.

The NDC model, completed with social and private pensions, represents a suitable model for Czechia and the EU.

## Mandatory private health insurance

In the area of health security/insurance models, the World Bank engaged significantly less than in the area of pension systems. Besides, the Chilean health insurance reform was not suitable for export. In addition to this, it would first be necessary to advise (from the model perspective) the government of the USA, where a market model is in force and it is not possible to apply the universal care standard, which is typical for other developed countries. Health care expenditure in relation to GDP in the USA are increasing faster than in other countries, this relation is double compared to other developed countries, whereas approximately one half of the expenditure is allocated to federal health care programs for poor and elderly. Approximately 46 million Americans do not have any insurance and further millions of Americans are underinsured.

Even though the domestic (US) health security problems are crucial, some ideas from the USA have been exported to Europe, specifically to the Netherlands and partially also to Czechia. An extensive health care reform has taken place in the Netherlands since 2006, inspired by the theory and reform proposals of the American professor A. Enthoven, which were, however, intended for the USA and not for the Netherlands. A. Enthoven calls his system as the managed competition system. It is a mandatory private insurance system, with very strong government regulation, including significant social elements. In the Netherlands, the system tends to be characterized as a private insurance with public guarantees or as a hybrid system (a combination of the social and private insurance).

The standard private health or sickness insurance has its characteristic construction elements derived from the equivalency principle and its implementation within the market environment. Prior to concluding an insurance policy, a private insurance company shall assess the client's health, trying to reflect the ascertained facts in the amount of insurance premium. A contract is simply not concluded at all in case of bad risk. In order to diversify risks and increase insurability, individual contracts and whole stocks are subject to reinsurance. Insurance contracts are concluded for a limited period of time, i.e. not from a birth till death. Under market conditions (USA), hundreds of thousands of products are offered by thousands of dealers. Most insured Americans are insured through their employers – i.e. only in the course of their employment.

On product basis, the mandatory private health insurance in the Netherlands significantly differs from a "standard" private health insurance (similarly as for other mandatory private insurance covers – e.g. "third party liability insurance"; this is common). In principle, it applies that a product is the same as it is / would be within a social insurance. In order to make this possible, everything necessary must be included in the relevant acts or agreed in line with statutory rules. However, insurance policies are arranged in line with private law, and insurance companies represent (special type) private insurance companies; they may also be established as nonprofit organizations.

Any differentiation of insurance premium according to risk (age, gender, health) is forbidden in respect of the Dutch mandatory private health insurance, and private health insurance companies must enter into an insurance policy with any (eligible) applicant. Insurance companies do not create fundamental actuarial provisions, i.e. "aging provisions" within the private health insurance. Had they created such provisions (within the constant insurance

premium system), these funds would, overall, be higher than in the pension insurance – this could be an impulse for the supporters of the mandatory private pension savings model: calculate the implicit public health debt and propose the creation of provisions, which health insurance companies would allocate on the capital markets – resulting, in line with their theories, in economic growth.

In the Netherlands, economically speaking, the government actually purchases (majority of) health insurance for its citizens from specialized private insurance companies; the insurance companies are selected by people. An insurance company will receive a (capitation) payment for each insured person, differentiated by age and gender as well as by approximately 30 major diseases (which the clients suffered from during the preceding period). Extremely expensive care is detached as a separate “pillar”, which has the nature of social insurance. On model basis, an insurance company receives a payment from the Central health fund in the form of risk premium insurance. The “redistribution of insurance premiums” works similarly in Czechia. The revenue of the Central fund comprises “earnings-related insurance premiums”, paid as a percentage from income (up to an earnings ceiling); employers pay 50% of the insurance premiums on behalf of their employees (since 2007).

Another important component of the system is the “nominal insurance premium”, which is determined by the health insurance company in respect of its clients. This nominal insurance premium is paid to the insurance company by its insureds with the exception of the state insureds (children up to the age of 18) – the government pays the insurance premium on behalf of such persons. The “nominal insurance premium” is determined as a fixed amount ranging from approximately EUR 1000 – 1400 per year. It is possible to get a group discount (mainly discounts for employees) of up to 10%. The persons in need are entitled to a state contribution to the nominal insurance premium; approximately 40% of all insureds receive this state contribution. In respect of adults, the “nominal insurance premium” covers approximately 50% of costs of the relevant health care (on an average). The basic health care package included in the mandatory private health insurance is identical for all; however, it was possible to negotiate a deductible of EUR 100 – 500. The deductible has been mandatory since 2008 (min. EUR 155 per year), with the fact that it does not apply to minors up to the age of 18 as well as to some forms of health care. In 2006 – 2007, it was possible to arrange a no-claims bonus in the amount of up to EUR 255. The purpose of these constructions as well as the whole system of the “nominal insurance premium” is for clients to take into account the health care costs. The overall level of deductibles is considered to be low; the administrative costs (including profit margin) of insurance companies amount to approximately 5% of the insurance premium (Leu, 2009).

The Dutch “nominal insurance premium” represents an average private insurance premium for all clients of the relevant private insurance company. In respect of standard private insurance coverage, insurance premiums are differentiated on the basis of risk and not income (as is the case for social insurance). No insurance premium should exist in the model of state health care provision, which dominates in Czechia – it is a public expenditure program, financed from taxes – similarly as other public expenditure programs.

The Dutch health care financing model may be characterized, as for insurance premiums, as the system of average, universal insurance premium, which covers one half of the relevant

health care; the other half of the health care is covered by the government in the form of subsidies depending on age, gender, and health of individual private insurance companies' clients. Globally speaking, the government subsidizes the mandatory private health insurance to the extent of 50%. The other insurance premium – the so-called earnings-related insurance premium – is not systematic, because it is an income tax; this tax should be combined with the general income tax. From the perspective of a model, it does not make any sense for a government to levy special/separate income tax for financing of the health care (50%).

The main purpose of the “nominal insurance premium” may be for clients to at least partially realize high health care costs. From this price (“nominal insurance premium”), insurance companies grant discounts for (higher than obligatory) deductibles. It is easy to image the existence of such constructions within the social insurance system or state health security system. The question is, however, the effectiveness of such instruments, including expended administrative costs. However, it is not necessary to privatize health insurance companies for these constructions alone.

In the Netherlands, approximately 1.5% of the population (240 000 people) lack any form of insurance – majority being immigrants and their children (even though the state pay the insurance premium for children). Sanctions apply to uninsured persons, which exceed the amount of the nominal insurance premium (by 30%). Further 1.5% of people arrange an insurance policy, but they do not pay any insurance premium. Insurance companies may get rid of these insureds.

Since 2006, there has been a rapid concentration of the mandatory health insurance market; 4 insurance companies currently control 88% of the market. The existing evaluations of the Dutch reform are quite noncommittal, with a reference to the relatively short period of application. The reform was mainly aimed at cost cuts and at empowering the role of consumers. In respect of quality in terms of the consumer protection, the Netherlands has ranked first in the world, followed by Denmark and Austria (Euro Health Consumer Index). However, the Netherlands claimed victory in this competition in 2005 as well. The classification does not include health care costs. Germany took sixth place (out of 33 European countries); the report (Björnberg 2009) states Germany is a “mysterious” country, with its health care system most focused (in Europe) on consumers, without restrictions and furiously increasing costs. As a speculative explanation, the report states that German doctors work harder. According to the aforementioned classification, Czechia is in the middle of the pack. Another conclusion of the report is that countries practicing the Bismarck model are beating countries practicing the Beveridge model.

The insureds in the Netherlands may arrange for a private supplementary health insurance, and most of them do it. The basic health care package covered by the mandatory insurance does not include dental care, physical therapy, glasses, and cosmetic surgeries. The supplementary insurance is arranged with the same insurance companies, which hold licenses for the mandatory insurance; however, it is not necessary to arrange such supplementary insurance with the same insurance company, in which clients have their basic insurance.

The health care reform, which was prepared by the Czech minister T. Julínek, was inspired by the Dutch reform. However, only the so-called regulatory fees have been implemented,



which led to the election defeat of the Civic Democratic Party (ODS) in the 2008 regional elections, and subsequently to the fall of the Topolánek's Cabinet in 2009. Julínek's reform did not have a corresponding political support, unlike the Dutch reform. It is also a fact that the previous Dutch health care system significantly utilized private insurance and other private sector attributes.

In terms of Europe, private health care insurance is also significantly used in Switzerland (since 1996). The Swiss system is much closer to the standard private insurance than in the Netherlands; however, on the other hand, insurance companies have the form of nonprofit organizations only. There are significant differences in individual "details" of the two systems.

A health care reform had been taking place in Slovakia since 2003; however, many attributes of the reform were either removed or deactivated after the 2006 election. The planned concept the Julínek's reform in Czechia was roughly the same as the implemented Zajac's reform in Slovakia.

Efforts aimed at using certain construction elements of the private insurance or efforts aimed at the utilization of economic instruments in order to reduce the pressure on health care expenditure increases, are absolutely logical. The same is being attempted by various theoreticians and practitioners within the social insurance or national health service systems as well. At the same time, additional modifications take place everywhere, after the execution of reforms, aimed at intensifying as well as correcting the reform. Both the Dutch system of "private insurance with state guarantees" and the Swiss system (operating since 1996) are at this stage.

The interim results of the Dutch reform have not proven the effectiveness of health insurance companies' privatization (in spite of the fact that nonprofit organizations operate / may operate in addition to typical private insurance companies). Perhaps, it will become obvious that health care costs can be better regulated by a system of detailed central control – as existing in Czechia – or within a national (or mainly regional) health service system in Sweden. In any case, it is not effective and professional to argue in favor of private health insurance companies, for example, by solely claiming that a private company always works better than a public company and that nothing beats joint-stock companies. It may have been sufficient for the Chicago Boys in Chile 30 years ago or in 1994 in the World Bank. The relevant pension model, corresponding to this health insurance model, is passé in Europe. The only fact is that some Czech national economists (even from the former National Economic Council of the Government) and journalists have not realized it yet.

The mandatory private health insurance system strongly reminds of the mandatory private pension savings model; however, its Dutch version is very sophisticated, and it cannot be ruled out that this system will generally continue to work – better than different systems in other countries. At this point, we are not only interested in this system (or another system / model) as such; we are interested in the social security as a whole, including health care. In this regard, we will have to decide, whether to aim at a comprehensive social security concept (including health care) or whether to reform health care, irrespectively of other social security branches and/or tax system.

The Dutch concept of health care regulation – similarly as the Slovak reform and Julínek's reform – establishes new state supervision authority over health insurance companies. It is intended even for supervision over private supplementary insurance, which should do with the existing supervision over the private insurance sector; this does not rule out the supplementation/amendment of relevant acts; e.g. Insurance Policy Act, which regulates private insurance products. In respect of the social insurance model and national health service model, the state supervision authority over insurance companies is not necessary.

### **Pan-European social security model**

It is a pity that the World Bank or some other institution does not offer an analogy to the Pan-European pension system for the health security. We should try to create a model of such a system. And we should even try to interconnect it with other parts of the social insurance or security model, especially with sickness and disability insurance.

Our hitherto research and personal experiences have complied with the Pan-European pension system concept, the primary element of which is:

- Modern social pension insurance in the form of the NDC system;

Completed with other significant “wings” / systems, namely:

- Social pensions; and
- Private pensions.

Another fundamental social security system may be the Pan-European health, sickness, and disability system, the primary element of which would be:

- Modern social health, sickness and disability insurance;

Completed with other significant “wings” / systems, namely:

- Social health and disability care benefits; and
- Private supplementary health, sickness and disability insurance.

Simultaneously with the reforms aimed at the fulfillment of the Pan-European pension system and the Pan-European health, sickness, and disability system, we need to reform the connected tax / subsidy system in Czechia, because it has been significantly departing from a meaningful system. I do not know whether a Pan-European tax system would have to be established first, but we definitely need to clarify that a standard model of taxes and social insurance comprises:

- Social insurance premiums assessed from earnings up to a earnings ceiling, deductible from the income tax base;
- Integration of all pecuniary social insurance benefits in the income tax base;
- Integration of all pecuniary social insurance benefits in the basis of assessment for the social insurance premiums.

Furthermore, we need to clarify that the primary form of the state support of private pensions and private health, sickness, and disability insurance is:

- Deduction of contributions for private pensions and private health, sickness, and disability insurance premiums (up to the earnings ceiling) from the income tax base; and
- Integration of private pensions and pecuniary benefits from the private health, sickness, and disability insurance in the income tax base; whereas other forms of state support are redundant.

If we are liberals and for this reason, we oppose the social insurance system, but we propose, for example, an introduction of universal pensions, it is necessary to be consistent and propose an introduction of a head tax (it may even be called an universal insurance premium), or – even better – to do without such a tax. In case we refuse social insurance, we must also refuse social insurance premiums.

## Summary

The Bismarckian social insurance model combines two basic principles: the equivalence principle and the social solidarity principle. In the old age social pension insurance the equivalence principle dominates whereas in the health & sickness social insurance branch the social solidarity prevails. The earnings ceiling plays a substantial role in this model: one ceiling for the computation of insurance premiums and as well as for the computation of pecuniary benefits. Originally the funded system of financing was used in this model; due to economic and political reasons the transition to PAYG financing occurred. The NDC system is a modern social insurance model.

The Beveridge model includes universal pecuniary benefits financed through universal contributions and a tax-financed separate national (public) health service system. The pensions in this system respect the liberal concept of the authors whereas the universal health care system covers all population at a relatively high level. This pension system was in practice substantially modified by the introduction of other important pillars.

The Chicago Boys introduced an opt-out to the private pension and health insurance system in Chile. The Chilean pension reform, heavily supported by the Pinochet government, was explained as a big success and taken over as the basic form of the World Bank concept of pension reform, with the mandatory private savings pillar as its core. To push through this pension reform concept the World Bank report of 1994 used all many theoretical devices such as the so-called “Aaron rule” and “implicit public pension deficit” is. The author reveals that the pushed-through privatization of old age pensions (savings) could be realized without involving the pensions (savings) themselves. This privatization represents an emergence of a massive real public debt, with the transfer of the money borrowed in this way to the private sector – expecting a higher return from this investment than the interest paid on the new public debt. If this construct were correct then it should be realized in the health insurance sector as well.

In the process of pushing through the privatization of public pension system (mainly in the post-Communist countries) the World Bank was changing its recommendations. A characteristic “semisolution” is the “diversification theory and policy” explaining that the best solution

is a mix of two mandatory pillars – a public one and a private one. The “Security through Diversity” slogan was used especially in Poland and this approach was “fully” (50:50) realized in the pension reform in Slovakia.

The new conditions in the health care sector require a substantial modification of the old universalism principle, leading to more “pillars” in the provision and financing of the health care. In Czechia there was an attempt to realize a health insurance privatization of a Dutch type, partly using also the Slovak privatization concept. Due to the lack of political consensus this Czech reform failed soon. The Dutch experience shows that it has not proved up to now that the managed-competition system is efficient as for controlling the costs of the private health insurance providers.

From 2003 many World Bank managers recommend to introduce a Pan-European pension model in the European Union countries, consisting of one public mandatory pillar in the form of NDC and two standard other pillars: (tax-financed) social pensions and voluntary private pensions. The author supports this approach and recommends extending it to other social security branches, having in mind especially a potential Pan-European health, sickness, and disability model.

## References

- BARR, N.; DIAMOND, P.** The Economics of Pensions. *Oxford Review of Economic Policy*, 2006, no. 1.
- BJÖRNBERG, A.; CEBOLLA, B.; LINDBLAD, S.** *Euro Health Consumer Index 2009*. Stockholm: Health Consumer Powerhouse, 2009. [Cited 2009-11-17] Available at: <http://www.healthpowerhouse.com/files/Report-EHCI-2009-090925-final-with-cover.pdf>
- BJÖRNBERG, A.; UHLIR, M.** *Euro Health Consumer Index 2008*. Stockholm: Health Consumer Powerhouse, 2008. [Cited 2009-11-14] Available at: <http://www.healthpowerhouse.com/files/2008-EHCI/EHCI-2008-report.pdf>
- HOLZMANN, R.; HINZ, R. et al.** *Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform*. Washington: The World Bank, 2005.
- HOLZMANN, R.; PALMER, E. et al.** *Pension Reform: Issues and Prospects for Non-Financial Defined Contribution (NDC) Schemes*. Washington: The World Bank, 2006.
- CONDE-RUIZ, J. I.; PROFESTA, P.** The Redistributive Design of Social Security Systems. *The Economic Journal*, April 2007. [Cited 2009-11-20] Available at: <http://www.valt.helsinki.fi/blogs/poutvaar/CondeRuizProfeta.pdf>
- KANE, Ch.; PALACIOS, R.** The Implicit Pension Debt. *Finance and Development*, June 1996 [Cited 2009-11-20] Available at: <http://www.imf.org/external/pubs/ft/fandd/1996/06/pdf/kane.pdf>
- LEIVA, F.** *Chile's Privatized Social Security System: Behind the Free-Market Hype, A Scam*. [Cited 2009-11-14] Available at: [http://www.networklobby.org/connection/chile\\_ss\\_may05.pdf](http://www.networklobby.org/connection/chile_ss_may05.pdf)
- LEU, R. E. et al.** *The Swiss and Dutch Health Insurance System: Universal Coverage and Regulated Competitive Insurance Markets*. Commonwealth Fund publ. No. 1220, 2009. [Cited 2009-11-14] Available at: [http://www.commonwealthfund.org/usr\\_doc/Leu\\_swissdutchhltinssystems\\_1220.pdf?section=4039](http://www.commonwealthfund.org/usr_doc/Leu_swissdutchhltinssystems_1220.pdf?section=4039)

**OECD.** *Pensions at a Glance 2009. Retirement-Income Systems in OECD Countries.* Paris: OECD, 2009.

**ORSZAG, P. R.; STIGLITZ, J. E.** *Rethinking Pension Reforms: Ten Myths about Social Security Systems.* Contribution to the conference of the World Bank. Washington: 1999. [Cited 2009-11-14] Available at: [http://www.ssc.wisc.edu/~scholz/Teaching\\_742/Orszag-Stiglitz.pdf](http://www.ssc.wisc.edu/~scholz/Teaching_742/Orszag-Stiglitz.pdf)

**PAŽITNÝ, P.** Reform in Slovakia set V4 in motion. Health Policy Institute. *Into Balance*, March 2008. [Cited 2009-11-14] Available at: [http://www.hpi.sk/images/newsletter/intobalance\\_03-2008.pdf](http://www.hpi.sk/images/newsletter/intobalance_03-2008.pdf)

**PIÑERA, J.** Retiring in Chile. *The New York Times*, 1. 12. 2004. [Cited 2009-11-14] Available at: <http://www.nytimes.com/2004/12/01/opinion/01pinera.html?oref=login&pagewanted=print&position>

**The World Bank.** *Averting the Old Age Crisis. Policies to Protect the Old and Promote Growth.* New York: Oxford University Press, 1994.

**TRESCH, R. W.** *Public Sector Economics.* New York: Palgrave Macmillan, 2008.

**VOSTATEK, J.** *Sociální a soukromé pojištění [Social and Private Insurance].* Praha: Codex Bohemia, 1996.

**VOSTATEK, J.** Vládní selhání Světové banky [Government Failures of the World Bank]. *Ekonom*, 1998, No. 46.

**VOSTATEK, J.** *Ekonomie a politika penzijní reformy: sociální pojištění versus soukromé spoření [Economy and Pension Reform Policy: Social Insurance Versus Private Savings]. Sociální politika*, 1999, No. 3.

**VOSTATEK, J.** Sociální důchodové pojištění můžeme mít také [We Can Have the Social Pension Insurance as Well]. *FÓRUM sociální politiky*, 2009, No. 3.

**WHITEHOUSE, E.** *Pensions Panorama. Retirement-Income Systems in 53 Countries.* Washington: The World Bank, 2007.

## Contact address / Kontaktní adresa

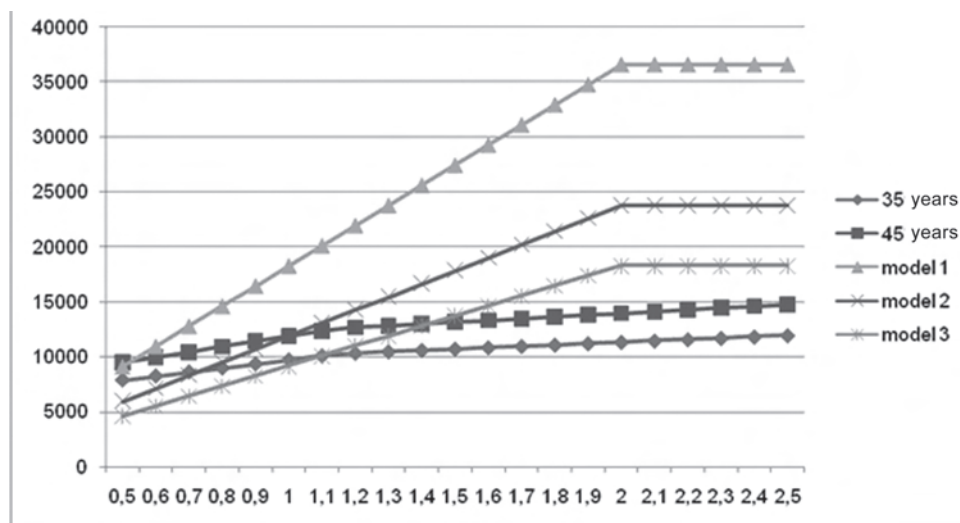
**prof. Ing. Jaroslav Vostatek, CSc.**

University of Finance and Administration  
([jvostatek@volny.cz](mailto:jvostatek@volny.cz))

**Figure 1:** Implicit Public Pension Debt as presented by the draftsman of the magazine Finance and Development, 1996



**Chart 1:** Relation of pensions and the multiple of an average earning: Czechia (35 and 45 years of insurance) and the Social Insurance Model (50%, 65% and 100% of net earnings)



**Chart 2:** Social expenditure as a percentage of GDP

