International Scientific Conference Pension Reform– How to proceed?

Mezinárodní vědecká konference Důchodová reforma – jak dál?

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Pension reform is the subject of academic research conducted by the University of Finance and Administration to an extent over and above the curriculum of this issue. This is also due to the fact that it is a highly topical issue for the Czech Republic. These are the reasons why on 5 May 2011 the University hosted the second international conference in a series of such conferences on this topic at the Grand Hotel Bohemia in Prague. In addition to three introductory lectures, the Scientific Committee included a total of 15 contributions to the discussion as part of the conference programme.

Robert Holzmann who, until recently, was Sector Director of the Social Protection Department of the World Bank, and this year became a recipient of a pension from the World Bank, staying on as an advisor to the World Bank and returning to the University of Vienna, was the keynote speaker. R. Holzmann stressed the need for improving and reforming existing pension systems within the European Union, supported the concept of the pan-European pension system, the main pillar of which is the modern version of social insurance, going by the NDC (Non-financial Defined Contribution system) acronym. The construction of this fully earnings-related insurance pillar is very simple and understandable for its participants. Experience with its application is very good in a whole number of countries in both Europe and beyond. It is simple to migrate to the NDC system from a similar so-called point social insurance system, which is employed, among other countries, in Germany and Slovakia.

R. Holzmann noted that the NDC and the pan-European pension system can be migrated to not only on the basis of EU-level co-ordination, but also "from below", drawing on the experience gained by neighbouring countries. The NDC could operate in the EU similarly to value added tax – to have common basic principles, giving wide room for the amount of the rates as well as for the overall weight of this component in the entire pension system. The concept of the pan-European pension system also places considerable emphasis on the social pillar, based on solidarity, and on a (consistently) voluntary private pillar. In his opinion, the financial crisis has reinforced the importance of private pension schemes; he emphasised the high real yields in the Polish system of mandatory private savings, on average over its entire duration.

The latest results of university research in the field of pension reform were presented by **Jaroslav Vostatek** (University of Finance and Administration). He supported the pan-European pension system and also a further increase in the retirement age proposed by the government. However, instead of the government proposal to change the bend points employed in the calculation of pensions, he recommended a fundamental, conceptual modification of the Czech Republic's entire public pension pillar – by way of its division into two pillars (social and insurance), in accordance with the concept of the pan-European pension system. He demonstrated, using a model case, the possibility of this fundamental reform, without reducing the pensions of insured from lower income groups. The proposal consists of a substantial increase in the basic pension amount assessed to 15% of average national wage and the abolition of bend points, while reducing the ceiling for the calculation of premiums to 150% of the average national gross wage.

The implementation of the pan-European pension system by the proposed method would lead to an increase in the old-age pensions of the insureds with average and above-average incomes. The necessary additional funds for this modification can be obtained by introducing a financial activities tax (a substitute for the missing VAT for the financial sector) and the reduction or abolition of state support for building savings (Bauspar), supplementary pension insurance and private life insurance. Reducing these subsidies will afflict those income groups whose state pensions will be increased, so that this will actually result in a simplification of the pension system. The existing pension entitlements can be calculated and further indexed, with the new scheme for calculating premiums and pensions only applying going forward.

Proposals for the creation, in one way or another, of a mandatory private pension pillar are vigorously supported, not only in the Czech Republic, by the relevant financial groups; these proposals have nothing to do with liberal conceptions of a pension system. The full or partial privatization of the public pension pillar is always associated with transformation costs that have a negative impact on the population and the state; this alone is sufficient reason to reject such a privatization. Nor does the shifting of the investment risk, mainly associated with the endeavour to rid providers of pension and investment products of this risk, to the insured have any rational economic or other basis. Social security pensions cannot, even in part, be met by way of an opt-out to private funds, where the insureds have to choose between alternatives, which virtually none of them can understand and for which only the insureds in the top 10% of the income earners can have sympathy, who can do without the relevant retirement savings. An example of a compromise that enjoys maximum acceptability in terms of investment risk is the Swiss system of mandatory occupational schemes with a return guaranteed at the level of inflation.

In his speech, **Jiří Král**, head director of the Ministry of Labour and Social Affairs, characterised the hitherto development of the Czech pension system and the need to carry out the envisaged pension reforms. Expenditure on public pensions has reached 9.2% of GDP in the Czech Republic. Average net old-age pensions represent 41.9% of average gross wages. Among the positives of the public pension system there is an increase in the employment of older persons, low poverty rate among older citizens, the uniformity of the system and successful premium collection. The negatives are: the unpreparedness of the system for ageing, insufficient equivalence in the amount of benefits, a scope of substitutive insurance periods unique in the world and low payments by the self-employed.

Ten private pension funds have 4.4 million participants, who contribute an average of CZK 433 per month and receive an average state contribution of CZK 105. Pension fund assets represent 5.9% of GDP, with the average real return on clients' investments being a mere

0.5% annually. The system of supplementary pension insurance as well as of private life insurance is a reliable one, the penetration is high, in addition to it the employers share is on the rise. The completed integration of pension funds is also a positive aspect. A downside is the small development in private savings for old age and low returns of private funds.

As expanded upon by J. Král, a consensus was reached within the framework of government advisory committees that the objectives of pension reform in this country are: diversification, fiscal sustainability, intergenerational distribution of the burden and increasing the equivalence of pensions and contributions into them. In the public first pillar, the government will implement parametric changes in the context of the response to the finding of the Constitutional Court, which ordered that the principle of equivalence between the premiums paid and the pension amount be reinforced. The Ministry of Finance, in cooperation with the Ministry of Labour and Social Affairs, is preparing the creation of the second pillar, in which the insureds will be able to divert a portion of the premium rate to their individual accounts. The Ministry of Finance is also preparing the transformation of the existing pension funds (third pillar).

The opening principal speeches were followed by a series of contributions from foreign as well as domestic academics and practitioners. **Hans Fehr** (The University of Würzburg and Netspar) presented a contribution titled "*Should pensions be progressive? Yes, at least in Germany*", co-authored by Manuel Kallweit and Fabian Kindermann. To measure pension progressivity, he uses the progressivity index, calculated by the OECD. He states that, in recent times, the payment of earning-related pensions has been reinforced, on average throughout the world, i.e. there has been a decline in the progressivity index. It has been concluded, based on the use of the overlapping generations model, that it is necessary to significantly strengthen the progressivity of pensions in Germany, the best way being for the share representing flat-rate pension reaching 40% of the total average amount of old-age pensions. With this diversification, the equivalence principle of insurance dominates over the labour supply distortions. The mere lowering of pensions (e.g. by the privatization of pensions) only reduces economic efficiency.

In his contribution, **Kenichi Hirose** (ILO) focused on the trends and basic problems of pension systems and reforms in Eastern and South-eastern Europe. He pointed out the erroneous policy of the World Bank, when in the past it pushed for privatization of the public pension system in an agreement with the IMF. He stressed the importance of social forces consensus on the form of the pension reforms and conflict of interest of the main players of the privatized systems in post-communist countries. Pension reforms can be implemented in accordance with international conventions of the ILO. The increase in employment among the young generation and the raising of the real retirement age by an increase in employment participation among the older generation are critical problems.

András Simonovits (Economic Institute, Budapest) had an aptly named contribution: "*The Mandatory Private Pension Pillar in Hungary: an Obituary*". In 1998, Hungary pioneered the privatization of pensions in Eastern Europe; the centre-left government employed the Chilean opt-out method, when the transfer to the so-called second pension pillar was only mandatory for new entrants to the labour market. The "voluntary" opt-out was exercised by 50% of the insureds, the employees with mandatory participation represented 25% of all employees in 2000. This so-called second pension pillar did not work; the returns were insufficient, and for most it would have been preferable to be fully in the public pillar. The international crisis compounded the problem of financing the costs of transformation (privatization), which led the current conservative Hungarian government to the de facto nationalization of the second pillar. Hungary is a typical example of how not to make pension reforms and anti-reforms.

Petr Mach (University of Finance and Administration) introduced the flat-rate pension model. The so-called flat-rate pension is one of the concepts of the state pension system, under which the state provides only a relatively low basic pension, which does not take the past incomes of a taxpayer into account. Financial security above the minimum pension is left up to a person's voluntary decision. The pension system in the Czech Republic is largely reminiscent of a flat-rate pension, because the state pension is levelled out considerably and only takes peoples' above-average income into account to a very limited degree. Flat-rate pension is a realistic option for pension reform with a clear objective: to reduce the degree of state redistribution and reduce the demographic risks on the state system.

Jaroslav Šulc (Czech-Moravian Confederation of Trade Unions) presented a contribution titled "*The Myths and the Reality of the Current Stage of Discussions on the Pension Reform in the Czech Republic*". The basic principles on which Drábek's pension reform stand have one thing in common - it's always a combination of a fact that is beyond professional dispute and its very purposeful explanation. If the government manages to push through the model of pension reform preferred hitherto, all profit will be collected by private companies operating the second pillar. If the proposal to transform supplementary pension insurance to pension savings also passes next year, nothing will change materially, but operators will finally be rid of the present-day duty to use their own money to cover any potential loss and will obtain a legal claim to a profit. And, after all, that is what they wish to achieve in both phases of the reform. If this manner of pension reform is being talked about as a way to achieve long-term stabilization of public finances, it is a myth of monstrous macroeconomic dimensions.

Vaclav Vybíhal (The University of Finance and Administration) had, in the very title of his contribution, posed the question; Pension Funds - cui bono? The state vigorously supports supplementary pension insurance, spends billions of CZK every year de facto in the form of mandatory expenditure. But the state monitors with little intensity what sense and effectiveness its investment in this project has and how intensively supplementary pension insurance influences and forms citizens' "reasonable" standard of living in old age. V. Vybíhal quantifies the effects of supplementary pension insurance in favour of the pension participant, state expenditure on supplementary pension insurance and their structure and analyses, using an example of one of the pension funds, how pension benefits from supplementary pension insurance actually contribute to improving citizens' pension situation in old age. He suggests, based on the findings collected, that this product be obligatory for employers and that self-employed persons who opt for this product benefit from tax advantages. With regard to the average returns generated, the product in question is not profitable enough without state aid and is de facto unsellable.

The conference also included contributions by: **Jiří Šindelář** (Union of Financial Advisors and Advisories), who asked "*What is the Role of Financial Distribution in Pension Reform, or: What Route Will the Reform Take to Get to Citizens?*" **Jan Mertl** (University of Finance and Administration) focused on "*The Links between Financing the Pension and Health Care System*". **Martin Potůček** (Faculty of Social Sciences, Charles University) presented a contribution titled "*Twelve Question Marks Hanging Over the Planned Pension Reform*", in which he focuses on the nature of the discussions pertaining to the reforms, the "big" as well as the "small" pension reform, as well as the broader context of the pension reform and its justification by the government. **Juraj Draxler** (CEPS Brussels and Anglo-American University) made a presentation on "*Retirement Reforms: Lessons from Public Debate*", as part of which he focused on pensions as a public policy problem, and included the case study of Slovakia. **Rudolf F. Heidu** (University of Finance and Administration) spoke on the topic "*New Findings from the German Pension Reform*". **Jiří Šteg** (ProAlt) presented a contribution titled "*The Pension System – An Instrument of Power or One of the Pillars of the Cohesive State?*" **Vladislav Pavlát** (University of Finance and Administration) focused on social reform as envisaged by Prof. Josef Macek and the present situation. The contribution of **Herbert Heissler** and **Petr Wawrosz** (both from University of Finance and Administration) dealt with "*The Funded Pension System and Gross National Savings*".

The progress of the Czech pension reform is an example of the quality of Czech politics – with tripartite coalition government negotiations resulting in the drafting of bills which essentially have no support, not only among the parliamentary opposition but even among the professional public, or any part of the scientific spectrum in the Czech Republic. We therefore consider it appropriate to continue focusing on this topic as part of our series of scientific conferences. The date of the next conference is tentatively set for October 2012, at which we will be pleased to welcome the authors of scientific work in this area.

The unabridged text of most of the contributions and presentations is available in the compendium to the conference, published by VŠFS-EUPRESS; email: jana.siroka@vsfs.cz.

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