Towards contributory approaches: pension reform in the transition countries

Draft version of a paper to be presented at the parallel session 'Ageing and Development 1'
at the DSA Annual Conference, Glasgow, September 10-12, 2003,

by

Dr. Katharina Müller
German Development Institute (DIE)
Tulpenfeld 4, D-53113 Bonn, Germany
e-mail: katharina.mueller@die-gdi.de

1. Introduction
2. The socialist legacy and the impact of transformation
3. Towards contributory approaches: post-socialist reform paths
4. The role of non-contributory benefits
5. Conclusions

Summary: Since the late 1980s, the process of economic transformation in Central-Eastern Europe and the Former Soviet Union has put great strain on existing retirement schemes. It soon became clear that the pension systems inherited from the socialist past were in dire need of reform. Although the reforms subsequently enacted in transition countries reflect considerable diversity, they share one common feature: a deliberate move from a universalist-redistributive heritage to strongly differentiated, earnings-related benefits, with an emphasis on contributory financing. Today the differences in level and scope of old-age protection are widening, both within and among transition countries. At the same time, plummeting formal employment translates into sharply decreasing coverage ratios. Thus, the importance of existing non-contributory benefits for the elderly, that currently play a rather marginal role in the post-socialist world, may soon be increasing.

1. INTRODUCTION

In recent years Central and Eastern Europe (CEE)[1] and the Former Soviet Union (FSU)[2] experienced far-reaching economic and social change that did not leave the area of old-age security unaffected. Pension reform seemed inevitable in CEE and the FSU when the process of economic transformation put great strain on the existing retirement systems. Today, the number of transition countries that have introduced far-reaching pension reforms in recent years is significant, when compared with the difficulties facing more modest reform attempts in the West. Nowadays, several transition countries have opted for partial or full pension privatisation, thereby following the much-advertised Latin American role models.[3] The introduction of notional defined contribution (NDC) plans, designed in Sweden, was pioneered in the Baltics and has been replicated elsewhere. The different reform paths share a common feature: a deliberate move from the universalist-redistributive heritage to strongly differentiated, earnings-related benefit levels. This paper analyses current pension reform trends in CEE and the FSU. While contributory pensions are high on the post-socialist policy agenda today, a closer look reveals the existence of non-contributory benefits for the elderly in most transition countries.[4]

This paper comes in five parts. The first section outlines the pre-1989 legacy in old-age security and the impact of economic transformation on the existing retirement schemes. Then, the different pension reform paths to be observed in CEE and the FSU are reviewed. These include parametric reforms and systemic reforms – i.e. the introduction of NDC plans and funded schemes –, while implying a strong emphasis on contributory financing. The following section identifies and discusses the existing non-contributory benefits for the elderly throughout the region. Finally, a critical evaluation of the state of pension reform and the role of contributory versus non-contributory approaches in the post-socialist world is ventured.

[1] Albania, Bosnia & Herzegovina, Bulgaria, Croatia, the Czech Republic, Hungary, Macedonia, Poland, Romania, Serbia & Montenegro (formerly FR of Yugoslavia), the Slovak Republic and Slovenia.

[2] Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[3] For the Latin American pension reforms see Mesa-Lago (2003).

[4] Here, the distinction between contributory and non-contributory benefits is largely based on the definition proposed by Barrientos and Lloyd-Sherlock (2002: 4) – whether or not 'payroll contributions to social insurance schemes constitute a prerequisite for entitlement'.

2. THE SOCIALIST LEGACY AND THE IMPACT OF TRANSFORMATION[5]

During the decades of socialist rule retirement schemes in CEE countries and the Soviet Union were organised along similar lines, yet without rendering national pension schemes identical. The central policy measure was the creation of a unified pension scheme integrated into the state budget, thereby cross-subsidising other expenditure items. Employees' contributions were abolished in most countries, rendering employers' contributions the only source of financing. As these were made as a percentage of the total payroll, were not registered on an individual basis and were not exclusively used for old-age security, they can be interpreted as wage tax rather than a pension contribution.

A major achievement of the post-war years was the gradual expansion of coverage, becoming universal by the 1960s or 1970s. As a rule, the legal pension age was decreased to 60 for men and 55 for women; while the effective retirement age was several years lower. Overall, the existing contribution-benefit link was weak: pensions tended to depend on years of service rather than on the level of contributions made on the insured's behalf. Consequently, and in a context of high labour participation rates, there was little benefit differentiation. Yet, pension privileges – a lower retirement age and higher benefits – granted for occupations of strategic importance marked an important departure from universalism.

The insufficient adjustment of current pensions to price or wage dynamics implied that newly granted pensions were considerably higher than average retirement benefits, giving rise to problems of inter-cohort fairness and of benefit adequacy. In Poland, this problem came to be known as 'old pension portfolio' – the longer a pension was drawn, the lower its purchasing power (Żukowski 1997: 138). Hence, many pensioners continued their gainful employment to top up their low old-age benefits.

Economic transformation affected the existing pay-as-you-go (PAYG) schemes in CEE and the FSU in several ways. At the onset of market-oriented reforms, price liberalisation and the curtailment of subsidies on basic goods and services required a shift from indirect to direct transfers, resulting in rising expenditure for old-age security. At a later stage, the restructuring of the state-owned enterprises had an effect on both the revenue and the expenditure side of public pension schemes. The privatisation, downsizing and closing-down of enterprises was accompanied by a mounting number of disability pensions and by early retirement policies. This policy, designed to disguise the employment effects of structural adjustment, implied that the retirement system was used as a substitute for welfare and unemployment benefits. By

[5] This chapter is a shortened and revised version of two corresponding sections in Müller (2002b).

leading to an increased number of pensioners and a falling number of contributors to the public pension schemes, this policy resulted in a significant destabilisation of public pension finances (Müller 1999).[6]

Table 1. Selected pension indicators for the transition countries

Country	Employed/ Labour Force Ratio	Contributors/ Labour Force Ratio	Pensioners/ Contributors Ratio	Old-Age Dependency Ratio[a]	Gross Replacement Ratio[b]	Pension Expenditure (% of GDP)
Albania	na	0.21	1.45	0.10	48.0	5.1
Armenia	0.74	0.27	1.19	0.12	na	na
Azerbaijan	0.87	na	na	0.10	23.0[c]	2.7
Belarus	0.75	na	na	0.19	41.0[c]	7.7
Bosnia	na	na	na	0.11	na	na
Bulgaria	na	0.76	0.74	0.22	31.0[d]	6.3
Croatia	na	0.66	0.62	0.20	31.6	11.1
Czech Republic	na	0.83[d]	0.51[d]	0.19[d]	44.0[d]	8.2[d]
Estonia	0.59	na	na	0.20	30.8	7.1
Georgia	0.25	na	1.20	0.18	na	1.7[c]
Hungary	0.49	na	0.78[c]	0.21	62.0[d]	9.7[c]
Kazakhstan	na	0.48	0.73	0.11	31.0[c]	7.1
Kyrgyzstan	0.36	na	0.64	0.10	45.0[c]	7.6
Latvia	na	0.60	0.80	0.21	40.0[c]	10.6
Lithuania	na	0.62	na	0.19	31.0[d]	6.2[c]
Macedonia	na	0.41	0.60	0.14	na	10.5
Moldova	0.78	0.58	0.62	0.14	42.0[d]	10.2
Poland	na	0.66	0.57	0.17	63.0[c]	13.7
Romania	na	0.54	0.66	0.18	31.0[d]	7.0[c]
Russia	0.69	na	na	0.18	38.0[c]	6.6
Slovak Republic	0.70	na	na	0.16	na	8.3
Slovenia	0.56	na	na	0.18	na	13.4
Tajikistan	0.82[c]	na	na	0.08	27.0[c]	3.0[c]
Turkmenistan	0.67	na	na	0.07	26.0[c]	4.0
Ukraine	0.52	na	na	0.21	32.0[c]	8.7[c]
Uzbekistan	0.90[c]	0.86	0.32	0.08	42.0	6.4[c]
Yugoslavia	0.30	na	na	0.19	na	na

[a] Non-Working Age (65+) population / Working Age (15-64) population
[b] Average Pension / Average Wage (in %)
[c] 1996
[d] 1995
Note: Data are from World Bank (2000) and for the most recent year available (1997; unless otherwise noted).
Source: Müller (2002b).

While the times of full employment are indeed over in the post-socialist countries, intra-regional differences in employment rates are considerable, as shown in Table 1. In 1997, the percentage of the labour force still employed had plunged considerably: only one out of three was still employed in Georgia, Yugoslavia and the Kyrgyz Republic, but four-fifths were in the other Central-Asian Republics. The percentage of the labour force contributing to the

[6] Cichon (1999: 91) aptly denominates this effect as the 'artificial ageing of a pension scheme'.

pension scheme had even dropped to 27 in Armenia and 21 in Albania. In some transition countries, there were already less contributors than pensioners, notably in Albania, Georgia and Armenia. It should be noted that in insurance-based schemes, a shrinking number of contributors translates not only into a declining revenue base in the short run, but also in plummeting coverage ratios in the future, thereby resulting in a gradual erosion of social insurance protection of the elderly.

Table 1 also highlights the divergent levels of public pension spending throughout the region. Eight years after the start of economic transformation, only Poland and Slovenia surpassed the West European average, with pension expenditures amounting to 13.7 and 13.4 per cent of GDP.[7] With expenditure levels between 1.7 and 4.0 per cent of GDP, pension spending was lowest in the Caucasian and Central Asian republics of Georgia, Azerbaijan, Tajikistan and Turkmenistan, where replacement rates hovered between 23 and 27 per cent of average wages. As shown in Table 1, the differences in pension spending are partly accounted for by the heterogeneous demographic background in the region. In Central Asia, the Caucasus, Albania and Bosnia, the old-age dependency ratio was only 7 to 12 per cent, while it amounted to 20 or above in Bulgaria, Hungary, Latvia, Ukraine, Croatia and Estonia. The regional average of life expectancy has declined in the transition countries – primarily due to high mortality of working-aged men in the FSU – and is now below the values for Latin America and the Caribbean (UNDP 2001; Müller 2002d).

3. TOWARDS CONTRIBUTORY APPROACHES: POST-SOCIALIST REFORM PATHS[8]

In the course of the 1990s, it had become clear all over the region that the old-age security systems inherited from the socialist past were in dire need of reform, to secure their financial sustainability, to meet the demographic challenges ahead and to adapt some of the previous design features to the new economic order. In the following, parametric as well as systemic reforms – the introduction of NDC plans and a move to funding – will be reviewed. Clearly, contributory pensions featured prominently on the post-socialist pension reform agenda.

Parametric reforms

It was relatively undisputed among social security experts in CEE and the FSU that essential pension reform measures included a higher retirement age, the abolition of branch privileges, tighter eligibility for invalidity pensions and for early retirement, the separation of pension

[7] The EU-15 average calculated by Eurostat was 12.6 per cent of GDP in 1998 (Amerini 2001).

[8] This chapter is a substantially shortened and updated version of three corresponding sections in Müller (2002b).

schemes from other social insurance plans and from the state budget, and – last but not least – the introduction of an employees' contribution. Even if dividing contributions among employer and employee is largely irrelevant in economic terms, post-socialist reformers found it important to introduce individualised contributions as part of a broader agenda geared towards self-provision and insurance-type arrangements, 'after decades of spoon-feeding' (Kornai 1997: 1186).

Moreover, benefits were linked closer to lifetime earnings to improve contribution incentives: e.g. in Bulgaria, Croatia, Romania and Serbia, German-style point systems have been introduced in the first tier (Müller 2003b; Vilnoiu and Abagiu 2003). Yet it should be noted that in a PAYG scheme, a greater differentiation of benefit levels requires extra financial means to improve the financial position of middle and high lifetime earners, if minimum benefits are already very low. Several FSU countries could hardly afford earnings-related pensions, spending scarce resources on benefits providing minimal consumption (Lindeman, Rutkowski and Sluchynskyy 2000). The introduction of automatic indexation rules amounts to yet another potentially costly measure. For fiscal reasons, it used to be a common practice to adjust retirement benefits only partially or in an ad hoc fashion to price and/or wage increases. In a context of high inflation, this resulted not only in insufficient retirement incomes, but also in a serious distortion of relative benefit levels.

To differing degrees, this parametric reform agenda has now been implemented in most CEE and FSU countries. Yet, some of the retrenchment measures – notably the increase in pension age and the abolition of branch privileges – met with considerable political resistance. Fierce resistance to parametric reforms, sometimes even by constitutional courts (e.g. in the Kyrgyz Republic and Poland), induced policymakers to compromise on the speed and/or scope of the required reform steps. In a number of countries reform has not been far-reaching enough, implying that retirees continue to suffer from the transformation-induced crises of existing retirement schemes. Notably in some FSU countries, statutory old-age benefits have fallen below subsistence level (Braithwaite, Grootaert and Milanovic 2000). Moreover, significant arrears have been reported in Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan (Castello Branco 1998).

Notional defined contribution schemes

Beyond the traditional distinction between defined benefit and defined contribution plans, NDC plans amount to an interim solution. All contribution payments are recorded in notional individualised accounts, yet capital accumulation is only virtual in these schemes. Individual

benefit levels depend mainly on past contributions and their notional rate of return; a discretionary factor, boiling down to an indexation of the virtual pension capital to the growth of the contributions base. Moreover, future benefit amounts are linked to the development of mortality and the chosen retirement age (see Box 1 for the Latvian example). Years spent in higher education, military service and raising children can be credited to individual accounts, provided the government assumes contribution payment for these periods.

Box 1. The Latvian NDC scheme

Notional defined contribution (NDC) plans, that introduce a quasi-actuarial pension formula to the public tier, have been developed by Swedish experts, but were pioneered by Latvia in 1996 (Cichon 1999; Müller 2002a; Bite and Zagorskis 2003). The Latvian pension formula can be simplified as

$$P = C / E,$$

with P = annual pension, C = total amount of indexed contributions accumulated by the insured, and E = remaining life-expectancy at the time of retirement. In the case of delayed retirement, P increases due to both a higher C and a lower E. The insured will receive annual statements about paid contributions and on the pension they would receive if retiring at age 60, 65 or 70. Meanwhile Poland and the Kyrgyz Republic have also introduced NDC plans.

The introduction of an NDC plan amounts to a fundamental change of the rules within the public tier, tying benefits closely to contributions and automatically adjusting the benefit level to a shortening of the period of contributions and/or an extension of the years in retirement. Advantages attributed to the NDC approach include a gain in transparency, endogenous adjustment to an increase in life-expectancy and greater incentives for formal employment as well as late retirement (Holzmann 1997). As regards disadvantages of NDC plans, they may increase old-age poverty, since they inherently withdraw the commitment to benefit adequacy. As they are essentially functioning on a PAYG basis, NDC plans will run into financial problems when birth rates are falling, unless benefits are indexed to the dynamics of the contributions base. Moreover, unexpected increases in longevity will affect current pensions from NDC plans in the same way as they do in private pension schemes. The instant differentiation of benefit levels intended by the introduction of NDC schemes is hampered by the fact that few CEE and FSU countries kept individual contribution records prior to 1989. Finally, early experience highlights that in order to function at all, an NDC plan presupposes the readiness and ability to make significant investments in sophisticated IT solutions.

Table 2. A comparison of post-socialist pension privatisations

	Implemented							Legislated	
	Kazakhstan	**Hungary**	**Poland**	**Latvia**	**Bulgaria**	**Croatia**	**Estonia**	**Lithuania**	**Macedonia**
Public mandatory tier	Closed down	Traditional PAYG scheme; private tier complementary	NDC[a] scheme; private tier complementary	NDC[a] scheme; private tier complementary	PAYG scheme with pension points; private tier complementary	PAYG scheme partly with pension points; private tier complementary	Traditional PAYG scheme; private tier complementary	Traditional PAYG scheme; private tier complementary	Traditional PAYG scheme; private tier complementary
Private[b] mandatory tier	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded	Individually fully funded
	Mandatory for all workers.	Mandatory for new entrants to labour market and optional for other workers to redirect part of their contribution to the private tier.	Mandatory for workers below 30 years of age and optional between ages 30 and 49 to redirect part of their contribution to the private tier.	Mandatory for workers below 30 years of age and optional between ages 30 and 49 to redirect part of their contribution to the private tier.	Mandatory for all workers up to 42 years of age to redirect part of their contribution to the private tier.	Mandatory for workers below 40 years of age and optional between ages 40 and 49 to redirect their contribution to the private tier.	Mandatory for workers below 18 years of age and optional for other workers to redirect their contribution to the private tier.	All workers may redirect part of their contribution to the private tier.	Mandatory for new entrants to labour market and optional for other workers to redirect part of their contribution to the private tier.
	Individual contribution rate: 10%	Individual contribution rate: 8%	Individual contribution rate: 9%	Individual contribution rate gradually increasing to 10%	Individual contribution rate yet to be defined (2-5%); it will be paid in equal shares by employers and employees	Individual contribution rate: 2.5% + employer's contribution rate: 2.5%	Individual contribution rate: 2% + employer's contribution rate: 4%	Individual contribution rate gradually increasing to 5.5%	Individual contribution rate: 7%
	from 1998	from 1998	from 1999	from 2001	from 2002	from 2002	from 2002	from 2004	[c]
Type of reform	substitutive	mixed	mixed	mixed	mixed	mixed	mixed	mixed	mixed

[a] NDC = Notional Defined Contribution.

[b] Although the IFF tier is dominated by private pension administrators, some countries also admit publicly run pension funds.

[c] In Macedonia, the second tier was legislated in March 2000. The implementation date has been postponed repeatedly.

Sources: Müller (2002b), GVG (2003), *Pensions International* (various issues).

The move towards funding

In most CEE countries, Russia, Moldova and the Baltics, a first change in the public-private mix was brought about by introducing supplementary private schemes on a voluntary, individually fully funded (IFF) basis. This move was intended to strengthen the idea of self-provision for old age, hence these programmes were largely organised as personal pension funds. Inspired by the West European example, some countries also set up occupational schemes, sponsored by employers. The newly introduced pension funds were expected to provide long-term investment capital, thereby contributing to the development of the local capital markets. Yet, the amount of voluntary funds collected fell short of expectations, highlighting both income constraints and a widespread mistrust of domestic financial institutions after a series of scandals and crises.

Nine CEE and FSU countries – among them five out of eight post-socialist EU accession candidates – have recently opted for a more radical move: full or partial pension privatisation (see Table 2). While only Kazakhstan substituted its PAYG system entirely with an IFF scheme, Hungary, Poland, Latvia, Bulgaria, Croatia and Estonia introduced mixed systems, partly diverting pension insurance contributions from the public PAYG scheme to a mandatory funded tier.[9] Similar reforms have recently been legislated in Macedonia and Lithuania.[10] Other transition countries considering the partial privatisation of their pension schemes include Armenia, Azerbaijan, Georgia, Romania, Russia, Slovakia and Ukraine.

The most iconoclastic pension reform was implemented in Kazakhstan (1998). All Kazakh workers, regardless of their age, are required to contribute 10 per cent of their gross wage to one of the newly set up pension funds. Although most of them are private, there is one public pension fund providing an asset guarantee. Interestingly, the state fund was the initial choice of over 85 per cent of all Kazakh employees (Orenstein 2000).[11] An extra 15.5 per cent of gross wage was collected to finance the existing pension obligations and outstanding arrears.

A partial pension privatisation was implemented in Hungary (1998), Poland (1999), Latvia (2001), Bulgaria, Croatia, Estonia (all 2002), and recently legislated in Lithuania and Macedonia. In these countries, the post-reform pension system is of a mixed type, combining

[9] For the Kazakh reform see Andrews (2001), for the Hungarian reform see Augusztinovics et al. (2002), for the Polish reform see Chłoń-Domińczak (2002), for the Latvian and Estonian reforms see Müller (2002a), and for the Bulgarian and Croatian reforms see Müller (2003b).

[10] For the Lithuanian reform see Dobravolskas and Buivydas (2003); for the Macedonian reform see Landmann (2000).

[11] As of April 2001, assets under management with the State Pension Fund accounted for 38.9 per cent of the total, down from 52.5 per cent in late 1999 (*Pensions International*, April 2001: 8).

a mandatory public PAYG tier with a partially optional IFF system. The new two-tier scheme offers a purely public as well as a mixed pension option on a mandatory basis (see below). The first, PAYG tier is mandatory for all insured, at least as first tier, and will cover acquired pension claims by paying some sort of compensatory pension, to be topped up by post-reform pension claims if the insured decides to stick to the purely public pension option. The second, IFF tier consists of a newly created system of predominantly or exclusively private pension funds, financed by a contribution rate of 5 to 10 per cent (see Table 2).

Whether membership in the second tier is possible or even mandatory is usually a question of age. While Poles, Latvians and Croatians aged 50 and over, as well as pensioners, were required to remain in the old system, Poles and Latvians under 30 and Croatians under 40 years of age were obliged to join the new two-tier scheme. Those insured between 30 and 49 (Poland, Latvia) or 40 and 49 (Croatia) were free to do the same – alternatively, they could stay in the old scheme. In Hungary, all new entrants to the labour market were obliged to join the new scheme; all others who were not yet retired could choose between the purely public and the mixed option. In Lithuania all workers may opt to participate in the second tier, regardless of their age. In Bulgaria there is no optionality: those up to age 42 are required to participate in the second tier, while those above that age must remain in the old system.

While contributions to the newly created private pension funds are usually financed entirely by employees, policymakers in Bulgaria, Croatia and Estonia have recently opted for a co-financing of both mandatory tiers by employers' and employees' contributions (see Table 2). Another departure from the orthodox blueprint occurred in Latvia, where the Treasury acts as the sole asset manager for the first three years, while private asset managers will be admitted only afterwards.

Advocates of pension privatisation claim that the switch to a private, funded scheme increases long-term saving and investment and boosts capital market development, resulting in a greatly improved macroeconomic growth performance (World Bank 1994; Corsetti and Schmidt-Hebbel 1997). Due to its strict actuarial relationship between contributions and benefits it is thought to remove unfavourable incentives affecting labour supply and savings behaviour. Moreover, pension privatisation is expected to result in a restriction of the role of the state in old-age security and a reduction of public spending in the long term. It is also considered attractive due to imputed rate of return differentials between private and public pension schemes (Disney 1999).

The mixed reform path promises to diversify the risks inherent in both public PAYG schemes and private pension funds. Yet, economic and demographic risks are common to both types of schemes (Barr 2000). Future retirees may face considerable investment risks since capital markets in transition countries are still shaky. In a context of widespread state capture[12] they often lack an adequate legal and supervisory framework. Informed choices between the public and the private pension option, as well as among pension funds, presupposes understanding complex financial information (Davis 1998). Moreover, the fiscal burden caused by the transition to funding in CEE and the FSU will be considerable, since coverage was near-universal under the socialist retirement scheme. If the private tier underperforms and guarantees are insufficient, governments may find themselves obliged to support the elderly. Hence, even when the pension system is formally contribution defined, the risk of old-age poverty is ultimately borne by the state, facing sizeable contingent liabilities (Müller 2002c).

4. THE ROLE OF NON-CONTRIBUTORY BENEFITS

The previous section has made it clear that contributory approaches to old-age security, whether publicly or privately organised, feature prominently on the post-socialist pension reform agenda and in related research. However, a closer look at existing retirement schemes 14 years after the momentous changes reveals the existence of non-contributory benefits for the elderly in most transition countries. Although the available information on such benefits is incomplete and rather sparse, an attempt is made to document existing non-contributory elements and arrangements in the post-socialist world (see Table 3). These can take three different forms: (1) they may be paid in lieu of contributory benefits (as in Georgia); (2) they may be integrated into a contributory pension tier (a flat-rate part of the pension formula); (3) they may coexist with a contributory pension tier (as social pension, old-age allowance etc.). These different incarnations of non-contributory benefits will be discussed in the following.

As noted above, the benefit structure inherited from the socialist period was relatively compressed, while near-universal coverage of workers was guaranteed and contributions, made as a lump-sum percentage of the total payroll, were not registered on an individual basis. Thus, it was crucial how many years of service had been completed in which type of occupation, not whether the claimant's employer had paid contributions. In the early transition years, high inflation and severe fiscal imbalances implied a significant erosion of

[12] 'State capture is defined as shaping the formation of the basic rules of the game (i.e. laws, rules, decrees and regulations) through illicit and non-transparent private payments to public officials' (Hellman, Jones and Kaufmann 2000: 2).

the real value of retirement pensions, a flattening of the benefit structure and the accumulation of arrears. In most FSU countries, maintaining a minimally adequate income floor soon became the governments' overriding objective, turning pension systems into crude safety nets (Castello Branco 1998; Lindeman, Rutkowski and Sluchynskyy 2000). Nowadays only Georgia is still exclusively paying out flat-rate retirement benefits regardless of the employment record, but benefit levels are extremely low *and* there is an earnings test for working pensioners (see Table 3).

Box 2. Experiences with universal flat-rate benefits in the Baltic states and Poland

In CEE and the FSU, universal flat-rate benefits paid in lieu of contributory benefits seem to carry the stigma of an emergency measure – or worse. This will be illustrated for the Baltic states and Poland.

The three- to four-digit inflation rates they faced in the early 1990s forced the newly independent Baltic states to suspended the introduction of earnings-related pensions. When they introduced flat-rate benefits, this was a reaction to fiscal emergency and to the difficulties of benefit calculation in a context of high inflation. However, the move was considered a social injustice, and pensioners took to the streets to protest the low level of retirement benefits – which had been well above subsistence level in Soviet times. A move to earnings-related benefits was only a matter of time (Müller 2002a).

When a reform blueprint presented by the Polish Ministry of Labour in April 1995 proposed a two-tier public PAYG system, including a tax-financed, flat-rate 'civic pension' equal to 30 per cent of the national average wage, it met with strong criticism. Opinion polls revealed that the proposed universal pension tier conflicted with the prevailing notion of justice and that an earnings-related approach was far more popular with the majority of the Polish population (Müller 1999: 108).

Table 3 shows that a number of post-socialist countries have now moved halfway between a flat-rate, redistributive benefit and a fully earnings-related, contributory pension by introducing benefit formulae that consist of a flat-rate component and an earnings-related part (or an increment related to the number of contributory years). It should be noted, however, that this non-contributory part of the benefit formula is embedded in an essentially contributory context, in which overall eligibility conditions require contributory periods of up to 35 years (as in Albania). While the current pensioner generation indeed features long service periods due to socialist full employment policies, the substantial increase in required insurance periods, combined with a contraction of formal employment and soaring unemployment in the transition years, will drastically limit access to this redistributive component of pension benefits in the future.

Table 3. Non-contributory retirement arrangements in the transition countries

Country	Description of non-contributory elements and arrangement	Type
Albania	Basic flat-rate pension, equal to the minimum living standard, is awarded to all insured, plus earnings-related increment (after 35 contributory years).	2
Armenia	Basic flat-rate pension, equal to 3,000 dram (US$ 5.14), is awarded to all insured, plus bonus for each insured year (after 15–25 contributory years). Social pension, equal to 3,500 dram plus 1,300 dram for each dependent family member, is paid to disabled or single pensioners with limited means.	2, 3
Azerbaijan	Social pension, equal to 80% of the minimum wage, is paid to non-working citizens aged 65 (men) or 60 (women) or 55 (certain categories of mothers who are ineligible for the old-age pension).	3
Belarus	Basic flat-rate pension, equal to 55% of the wage base, is awarded to all insured, plus bonus for each insurance year in excess of required minimum (25/20 insurance years for men/women). Social pension, equal to 50% of the minimum pension (defined as 25% of the average per capita subsistence budget), is paid to non-working citizens aged 60 (men) or 55 (women), ineligible for an old-age pension.	2, 3
Bulgaria	Social pension, equal to 44 leva (US$ 20.14), for uninsured persons aged 70 and above; income-tested.	3
Czech Republic	Basic flat-rate pension, equal to 1,310 koruna (US$ 35.95), is awarded to all insured, plus earnings-related increment (after 15–25 qualifying years).	2
Estonia	Basic flat-rate pension, equal to 419 kroon (US$ 23.86), is awarded to all insured, plus bonus for each insured year (after 15 years of service). National pension, equal to 100% of the national pension rate (800 kroon), is paid to persons who are not eligible for an old-age pension.	2, 3
Georgia	Flat-rate pension, equal to 14 lari (US$ 6.31), is awarded regardless of the duration of employment, but there is an earnings test for working pensioners. Social pension, equal to 18 lari (one person) or 29 lari (two or more persons) is paid to those without other means of support.	1, 3
Hungary	Old-age allowance for vulnerable persons, i.e. an income supplement calibrated so as to reach 95% of the minimum old-age pension for singles or 80% per capita for couples.	3
Kazakhstan	Old-age social allowance, equal to 100% of the social minimum (4,336 tenge, or US$ 28.27), is paid to low-income pensioners and to citizens ineligible for an old-age pension.	3
Kyrgyzstan	Social assistance allowance, equal to 70–150 som (US$ 1.45–3.10), is paid to non-working citizens in pensionable age who are not eligible for an old-age pension; not income-tested.	3
Latvia	State social security benefit, equal to 30 lat (US$ 47.62), is paid to all persons at least 5 years older than the statutory retirement age; not means-tested.	3
Lithuania	Basic flat-rate pension, set at no less than 110% of the poverty level (138 litas, or US$ 34.59), is awarded to all insured, plus earnings-related increment (after 15 insurance years). Social pension, equal to the basic pension, is paid to those elderly ineligible for an old-age pension.	2, 3
Moldova	Social pension, equal to 50% of the minimum old-age pension (defined as 100 lei, or US$ 7.78), is paid to non-working citizens in pensionable age who are not eligible for an old-age pension; 100% of the minimum old-age pension for mothers of three or more children.	3
Poland	Basic flat-rate pension, set at 24% of average national salary (i.e. 495 złoty, or US$ 125, in 2001), plus earnings-related increment (after 20/25 insurance years).[a] Compensatory permanent allowance, equal to 18–447 złoty, is paid to low-income elderly who are ineligible for an old-age pension.	2[a], 3
Russia	Basic flat-rate pension is awarded to all insured, plus earnings-related increment (after a minimum of 5 insurance years). There is also a social pension.	2, 3
Slovak Republic	Social pension is paid to citizens aged 65 or above with no other pension entitlement above the subsistence level.	3
Turkmenistan	Social allowance, equal to 100% of the monthly minimum benefit (40% of the national minimum wage), is paid to those aged 67 (men) or 62 (women) and above and to persons not eligible for an old-age pension.	3
Ukraine	Basic flat-rate pension, equal to 55% of the wage base, is awarded to all insured, plus bonus for each insured year in excess of required minimum (25/20 insurance years for men/women). Social pension, equal to 23.3–59 hryvnia (US$ 4.44–11.24), for non-working citizens ineligible for an old-age pension.	2, 3

[a] Old system only, i.e. for those above age 50 in 1999, and for those aged 30–50 who chose to stay in the old system.

Notes: Non-contributory arrangements were not reported for Croatia, Romania, Serbia, Slovenia and Uzbekistan, and there was no information on Bosnia & Herzegovina, Macedonia and Tajikistan. For a definition of types 1, 2 and 3 see pp. 13–14.

Sources: SSA (2003a, 2003b); GVG (2003).

Moreover, a closer look at Table 3 reveals that except for the Albanian and the Czech case, a two-part benefit formula is now largely a feature of FSU pension schemes, while many other transition countries have already moved towards a fully earnings-related benefit calculation (see also Box 2). Alongside these contributory schemes, some of which even feature two earnings-related tiers – a public and a private one – (see Table 2), non-contributory benefits have been established to prevent or alleviate old-age poverty. Experience with such benefits is relative recent in the region, as it was assumed that poverty did not exist under socialism and consequently, little emphasis was placed on social assistance and poverty alleviation benefits (Andrews and Ringold 1999).

These targeted benefits – known as social pension, national pension, or old-age allowance – are tax-financed, and eligibility often presupposes a means test and/or an inactivity test. However, benefits are usually so low that their poverty-reduction function is severely hampered (see Table 3). In Lithuania the social pension amounts to 110 per cent of the poverty level, in Kazakhstan the old-age social allowance is equal to 100 per cent of the social minimum, in Azerbaijan the social pension is fixed at 80 per cent of the minimum wage, in Moldova the social pension equals 50 per cent of the minimum pension, in Turkmenistan the social allowance is fixed at 40 per cent of the minimum wage, while in Belarus the social pension amounts to no more than 12.5 per cent of the average per capita subsistence budget (see Table 3).

In the poorer transition countries, experiences with cash transfers are mixed at best. Due to permanent funding constraints, statutory benefits such as the ones listed in Table 3 are often paid months late, in kind or not at all, while local administrative capacities prove too weak to ensure efficient benefit administration in a context of wide-spread corruption (Transparency International 2001). These problems are especially pronounced in the Caucasus and in Central Asia, where some of those entitled found that claiming the benefit involved costs that exceeded the actual value of the allowance (Müller 2003a). Contrary to this, some of the wealthier transition countries, many of which EU accession candidates, are now starting to set up meaningful social assistance schemes that replace instruments of categorical targeting used elsewhere in the region. These newly established schemes will also attend the elderly in need, or vulnerable households containing older people (GVG 2003).

5. CONCLUSIONS

In the transition countries, the reform challenge was to rebuild the existing institutional framework in old-age security, that was largely similar at the onset of transformation. Yet, after pension reform had gathered momentum in CEE and the FSU, old-age security schemes started to exhibit increasingly dissimilar traits. While from an analytical perspective, it is useful to distinguish between parametric reform, NDC schemes and a change in the public-private mix, these reforms were not mutually exclusive. Pension privatisation was often accompanied or preceded by parametric reform. Both the reformed public and the new private schemes were supplemented with voluntary funded tiers, and NDC plans were combined with pension privatisation (see Table 2).

In most transition countries, these different reform patterns share one common feature: a deliberate move from the universalist-redistributive heritage to strongly differentiated, earnings-related benefit levels, with an emphasis on contributory financing. At the same time, the differences in level and scope of old-age protection are widening, both within and among transition countries (see Table 1). At the same time, plummeting formal employment is starting to translate into sharply decreasing coverage ratios. Thus, the importance of non-contributory benefits for the elderly, that currently play a rather marginal role in the post-socialist world, may soon be increasing if old-age poverty is to be avoided. Hence, it can be concluded that twelve years after the start of political and economic transformation, pension reform is still an unfinished task in many post-socialist countries.

Pension reformers in the region will need to find answers beyond the large-scale move from state to market which is currently taking place. Yet, it will not only depend on the chosen reform design whether the elderly in CEE and the FSU will fare better in the future than they do now. The economic and political context is of crucial importance. Nowadays, state capacities – especially extractive and administrative capacities – clearly differ widely throughout the region. Bönker (2001) finds that the advanced reformers (Central Europe and the Baltics) and the consolidated autocracies (Turkmenistan, Uzbekistan and Belarus) exhibit high extractive capacity and low indices of state capture; while the slow reformers (Albania, Bulgaria, Romania, Russia, the Ukraine, Kazakhstan and Kyrgyzstan) and the countries affected by civil war (Armenia, Azerbaijan, Georgia, Moldova and Tajikistan) are characterised by low extractive capacity and high state capture. As noted by Barr (2000: 23), 'if government is ineffective, *any* pension scheme will be at risk' – whether private or public, contributory or non-contributory.

REFERENCES

Amerini, Giuliano (2001). Social protection: expenditure on pensions, in: *Statistics in focus. Population and Living Conditions*, Theme 3 No. 9/2001, pp. 1–7.

Andrews, Emily S. (2001). Kazakhstan: An Ambitious Pension Reform, SP Discussion Paper No. 0104, Washington DC: World Bank.

Andrews, Emily S. and Dena Ringold (1999). Safety Nets in Transition Economies: Toward a Reform Strategy, SP Discussion Paper No. 9914, Washington DC: World Bank.

Augusztinovics, Mária, Róbert I. Gál, Ágnes Matits, Levente Máté, András Simonovits and János Stahl (2002). The Hungarian Pension System Before and After the 1998 Reform. In: Fultz, Elaine (ed.): Pension Reform in Central and Eastern Europe. Volume 1: Restructuring with Privatization: Case Studies of Hungary and Poland, Budapest: ILO-CEET, pp. 25–93.

Barr, Nicholas (2000). Reforming Pensions: Myths, Truths, and Policy Choices, Working Paper WP/007139, Washington DC: IMF.

Barrientos, Armando and Peter Lloyd-Sherlock (2002): Non-contributory pensions and social protection. Paper for the series ‘Issues in Social Protection’, Manchester and Norwich, mimeo.

Bite, Ināra and Valdis Zagorskis (2003). Latvia Country Study, Study on the Social Protection Systems in the 13 Applicant Countries, carried out for the Commission by GVG, <http://europa.eu.int/comm/employment_social/index_en.htm>.

Bönker, Frank (2001): Staatseinnahmen und staatliche Handlungsfähigkeit in den osteuropäischen Transformationsländern, Paper presented at the Conference ‘The EU Eastern Enlargement as a Milestone of Institutional Change in Eastern Europe’, Frankfurt (Oder), October 11–12, 2001.

Braithwaite, Jeanine, Christiaan Grootaert and Branko Milanovic (2000). Poverty and Social Assistance in Transition Countries, New York: St. Martin’s Press.

Castello Branco, Marta de (1998). Pension Reform in the Baltics, Russia, and other Countries of the Former Soviet Union (BRO), Working Paper WP/98/11, Washington DC: IMF.

Chłoń-Domińczak, Agnieszka (2002). The Polish Pension Reform of 1999. In: Fultz, Elaine (ed.): Pension Reform in Central and Eastern Europe. Volume 1: Restructuring with Privatization: Case Studies of Hungary and Poland, Budapest: ILO-CEET, pp. 95–205.

Cichon, Michael (1999). Notional defined-contribution schemes: Old wine in new bottles? In: *International Social Security Review*, Vol. 52 No. 4, pp. 87–105.

Corsetti, Giancarlo and Klaus Schmidt-Hebbel (1997). Pension Reform and Growth, in: Salvador Valdés-Prieto (ed.), The Economics of Pensions. Principles, Policies, and International Experience, Cambridge: Cambridge University Press, pp. 127–159.

Davis, E. Philip (1998). Policy Implementation Issues in Reforming Pension Systems, Working Paper No. 31, London: EBRD.

Disney, Richard (1999). OECD Public Pension Programmes in Crisis: An Evaluation of the Reform Options, SP Discussion Paper No. 9921, Washington DC: World Bank.

Dobravolskas, Algis and Romualdas Buivydas (2003). Lithuania Country Study, Study on the Social Protection Systems in the 13 Applicant Countries, carried out for the Commission by GVG, <http://europa.eu.int/comm/employment_social/index_en.htm>.

GVG (2003). The social protection systems in the 13 candidate countries, carried out for the European Commission, <http://europa.eu.int/comm/employment_social/index_en.htm>.

Hellman, Joel S., Geraint Jones and Daniel Kaufmann (2000). 'Seize the State, Seize the Day'. State Capture, Corruption, and Influence in Transition, Policy Research Working Paper No. 2444. Washington DC: World Bank.

Holzmann, Robert (1997). On Economic Benefits and Fiscal Requirements of Moving from Unfunded to Funded Pensions, Forschungsbericht 9702, Saarbrücken: Universität of Saarland.

Kornai, János (1997). Reforming the Welfare State in Postsocialist Societies, in: *World Development*, Vol. 25 No. 8, pp. 1183–1186.

Landmann, Robert S. (2000). Pension Reform in Macedonia. A Strategic Approach, Paper prepared for the OECD Conference 'Private Pension Systems in Central and Eastern European Countries and the New Independent States', Prague, April 3–7, 2000.

Lindeman, David, Michal Rutkowski and Oleksiy Sluchynskyy (2000). The Evolution of Pension Systems in Eastern Europe and Central Asia: Opportunities, Constraints, Dilemmas and Emerging Best Practices, Washington DC: World Bank.

Mesa-Lago, Carmelo (2003). Panorama de los Sistemas de Pensiones de Seguridad Social en Iberoamerica. Documento preparado para la II Conferencia Iberoamericana de Ministros Responsables de Seguridad Social Previa a la Cumbre de Jefes de Estado y de Gobierno de Iberoamérica, Pittsburgh PA, mimeo.

Müller, Katharina (1999). The Political Economy of Pension Reform in Central-Eastern Europe, Cheltenham and Northampton MA: Edward Elgar.

Müller, Katharina (2002a). Old-Age Security in the Baltics: Legacy, Early Reforms and Recent Trends, in: *Europe-Asia Studies*, Vol. 54 No. 5, pp. 725–748.

Müller, Katharina (2002b). Pension Reform Paths in Central-Eastern Europe and the Former Soviet Union, in: *Social Policy and Administration*, Vol. 36 No. 2, 2002, pp. 156–175.

Müller, Katharina (2002c). Public-Private Interaction in Structural Pension Reform. In: OECD (ed.): Regulating Private Pension Schemes: Trends and Challenges, OECD Private Pensions Series N° 4, Paris: OECD, pp. 105–116.

Müller, Katharina (2002d): Transformation als Peripherisierung, in: *INITIAL. Zeitschrift für sozialwissenschaftlichen Diskurs*, Vol. 13 No. 3, pp. 17–26.

Müller, Katharina (2003a). Poverty and Social Policy in the Central Asian Transition Countries, GDI Reports and Working Papers 2/2003, Bonn: German Development Institute.

Müller, Katharina (2003b). Privatising Old-Age Security: Latin America and Eastern Europe Compared, Cheltenham and Northampton MA: Edward Elgar.

Orenstein, Mitchell (2000). How Politics and Institutions Affect Pension Reform in Three Postcommunist Countries, Policy Research Working Paper No. 2310, Washington DC: World Bank.

Pensions International, various issues <http://www.pensionsinternational.co.uk>.

SSA (2003a). Social Security Programs Throughout the World: Asia and the Pacific, Washington DC, <http://www.ssa.gov/policy/docs/progdesc/ssptw/2002/asia/index.html>.

SSA (2003b). Social Security Programs Throughout the World: Europe, Washington DC, <http://www.ssa.gov/policy/docs/progdesc/ssptw/2002/europe/>.

Transparency International (2001): Press Release: The 2001 Corruption Perceptions Index <http://www.transparency.org/cpi/2001/cpi2001.html>.

UNDP (2001). Human Development Report 2001. Making New Technologies Work for Human Development, New York: United Nations Development Programme.

Vilnoiu, Mihai and Cristina Abagiu (2003). Romania Country Study, Study on the Social Protection Systems in the 13 Applicant Countries, carried out for the Commission by GVG, <http://europa.eu.int/comm/employment_social/index_en.htm>.

World Bank (1994). Averting the Old Age Crisis. Policies to Protect the Old and Promote Growth, Washington DC: Oxford University Press.

World Bank (2000). Balancing Protection and Opportunity. A Strategy for Social Protection in Transition Economies, Washington DC: World Bank.

Żukowski, Maciej (1997). Wielostopniowe systemy zabezpieczenia emerytalnego w Unii Europejskiej i w Polsce: Między panstwem a rynkiem, Poznań: Wydawnictwo Akademii Ekonomicznej.