

5th Conference of the LSEE Research Network on
Social Cohesion in South East Europe
in collaboration with EBRD

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Stream: Income inequality and social protection policies

**Pension policy developments
in SE Europe**

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Pension policy developments in SE Europe

(SE Europe = from Romania to former Yugoslavia)

Outline of presentation

Pension-policy-relevant features of the countries

Pension systems in the Balkan countries

Recent policy initiatives

Empirical evidence

Challenges to be faced

The role of the EBRD

Pension policy developments in SE Europe

Pension-policy-relevant features of the countries

Ageing populations

Little different from rest of Europe (except Kosovo)

Low labour force participation + high unemployment

Use of “early retirement” to relieve labour market

High level of “informal working”

Low tax collection rates

Evasion and contribution non-compliance

Fiscal problems

Pressures from IFIs and EU

Underdeveloped capital markets

Stock markets and banking system

Pension policy developments in SE Europe

Pension systems in the Balkan countries

	tax financed universal	public PAYGO	mandatory savings accounts	WB classification
Albania	X	DB		low spending
Armenia		DB	X	low spending
BiH		DB points	vol. in Rep Srpska	high spending
Bulgaria		DB	X ¹	low spending
Croatia		DB points	X ²	low spending
Kosovo	X	NONE	X	young
Macedonia		DB	X ³	high spending
Moldova		DB		low spending
Montenegro		DB points		high spending
Romania		DB points	X ⁴	high spending
Serbia		DB points		high spending
Slovenia		DB		high spending

¹ Contrib. increases stopped, now allows opt-outs; ² Now allows opt-outs; ³ Now allows opt-outs and reversion to PAYGO; ⁴ Has cut contributions and allows partial reversion to PAYGO

Source: based on WB, 2014, and own analysis

Pension policy developments in SE Europe

Recent policy initiatives

Repeated “parametric” reforms

- Moving up pension age (+ equalisation)

- Cutting benefits (including indexation changes)

- Increasing contribution periods

Unwinding “paradigmatic” reforms

- Dealing with “transition costs”

- Freezing amount diverted to funded accounts (Croatia)

- Threats to “nationalise” funded accounts (Bulgaria)

Late “paradigmatic” reformers

- Armenia (2014); “rumours” in Serbia and Slovenia

Pension policy developments in SE Europe

Recent policy initiatives (2)

Unwinding “paradigmatic” reforms

Dealing with “transition costs”

Disguised PAYGO “fake privatisation”

Maastricht rules and fiscal deficits and debts

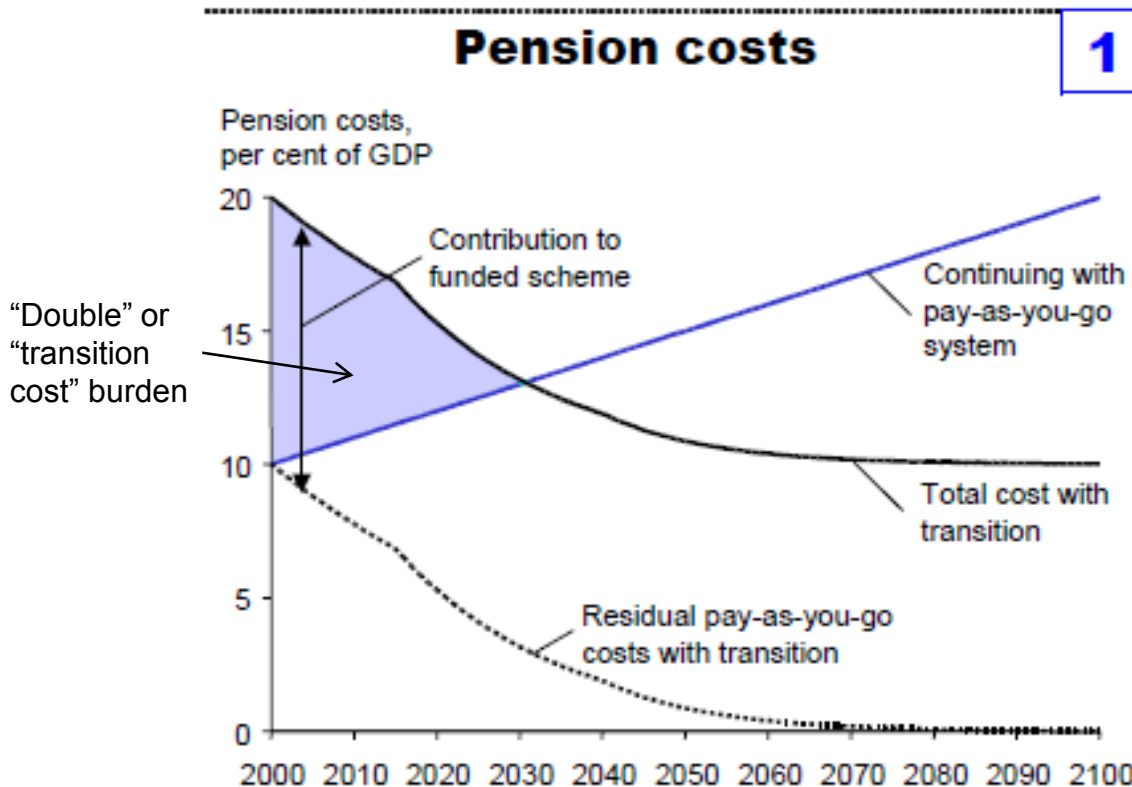
Is $R > G$ or $G > R$?

Charges on funds

Empirical evidence

Pension policy developments in SE Europe

Illustrating “transition costs”



assumption:

transition costs financed by

- 1) cuts elsewhere
- 2) additional taxes, contributions
- 3) benefit cuts
- 4) greater efficiency, better compliance
- 5) privatisation receipts
- 6) borrowing

but, money is fungible, so there is always an opportunity cost

Source: WB Pension Reform Primer

Pension developments in SE Europe

Is $R > G$ or $G > R$?

Samuelson-Aaron perspective*

where G =growth of wage sum and R =return on investment
PAYGO superior if $G > R$, funding superior if $R > G$

Blanchard and debate about historical r or i and g^{**}

where r or i = long govt. bonds and g =nominal growth
higher public debt might have limited welfare consequences and
no fiscal costs if $g > r$ or i

* Samuelson, P. A. [1958], An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money, in *Journal of Political Economy*, 66, 467- 482; Aaron, H. J.[1966], The Social Insurance Paradox, in *Canadian Journal of Economics and Political Science*, 33, 371-374.

** Blanchard, O. [2019], Public Debt and Low Interest Rates, in *American Economic Review*, 109(4): 1197–1229.

Pension developments in SE Europe

Empirical evidence

Countries with funded second pillar

	date of privatis- -ation	since inception until end 2007			since inception until end 2018			standard deviation	
		real return	GDP growth	diff	real return	GDP growth	diff	2nd pillar	GDP
Bulgaria	Apr-02	4.3	6.5	-2.2	1.2	3.5	-2.3	8.1	3.0
Croatia	May-02	4.5	4.8	-0.3	3.5	1.6	1.9	6.4	3.5
Macedonia	Feb-06	2.9	5.8	-2.9	3.2	2.8	0.4	6.6	2.2
Romania	May-08	n/a	n/a	n/a	4.8	2.3	2.5	4.3	4.2

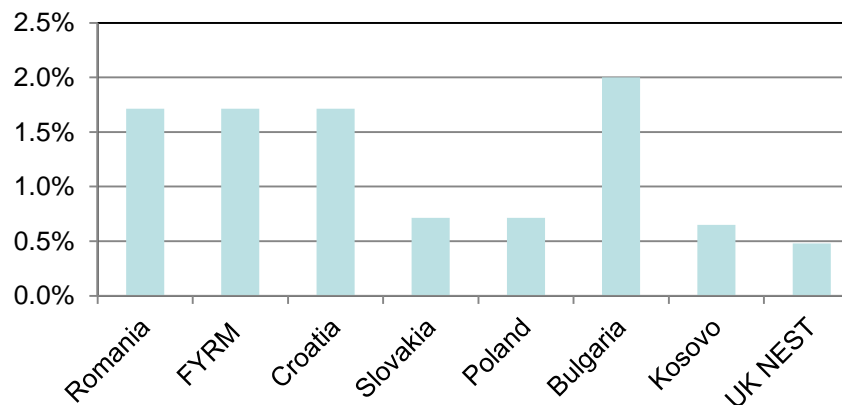
Note: Real returns represent semi-net returns. They exclude asset-based fees but include contribution-based fees.

Pension developments in SE Europe

Empirical evidence

High charges associated with individual accounts

Charges - % of
AUM, WB, 2014
and other sources



Impact of charges
- assuming 30 years saving

at 0%	100.0
at 0.5%	91.6
at 1%	84.0
at 1.5%	77.2
at 2%	71.0

Pension developments in SE Europe

Empirical evidence

Underdeveloped capital markets

Small domestic stock exchanges and little of “investment grade”

Reliance on investment in government bonds

Private schemes as “disguised” public systems

Asset Allocation (%) of 2nd pillar funds (mid/late 2018)

	govt debt	corp. bonds	shares	others
Bulgaria	48	15	33	3
Croatia	69	2	16	14
Macedonia	57	0	9	34
Romania	63	3	19	15
Kosovo	12	23	42	23

Source: national pension authorities

Impact of 4% “carve out” on debt as % GDP

year	accumulated debt
1	2.4
5	12.0
10	24.0
15	36.0
20	48.0
25	60.0

Source: own calculations (assuming wages=60% of GDP)

Pension developments in SE Europe

Challenges to be faced

Distrust of (financial) institutions

Albania and the 1997 pyramid investment scandal

2008-09 financial crisis and impact on Kosovo's KPST

Political opposition to WB/IMF (Serbia, Slovenia, Albania)

Protests in Armenia following 2014 reform proposal (a “racket”, allowing the government to “get its hands into people’s pockets”)

“Governance metrics”, rule of law, contract enforcement
– WB, TI, etc, – discouraging inward FDI

Pension developments in SE Europe

The role of the EBRD

EBRD unlike other multi-lateral lenders

No social policy or anti-poverty function (e.g. WB/IMF)

Promotion of privatisation

But more in general than in particular – not directly in pensions

Interest in development of financial markets

Stock markets as capital allocators

Concern about closure of Poland's 2nd pillar (2011-13)

Some interest in “long-term financing” and “infrastructure”, but only tangential refs to pension funds

Investor in pension fund providers (AXA until 2009, PRVA, 2007-17, EPF, 2017-)

Limited research in pensions issues

Mainly in earlier period

Pension developments in SE Europe

The role of the EBRD (2)

Appropriate old-age benefit schemes

WB “Pillar 0” or “universal” = flat rate, anti-poverty benefit (Kosovo and Albania as examples?)

But avoid discrimination in application (minorities)

Well-managed supplementary fund (Kosovo?)

But make it voluntary

Develop administrative capacity

And avoid the “siren call” of the IFIs

Get the “economy” right, “stupid”

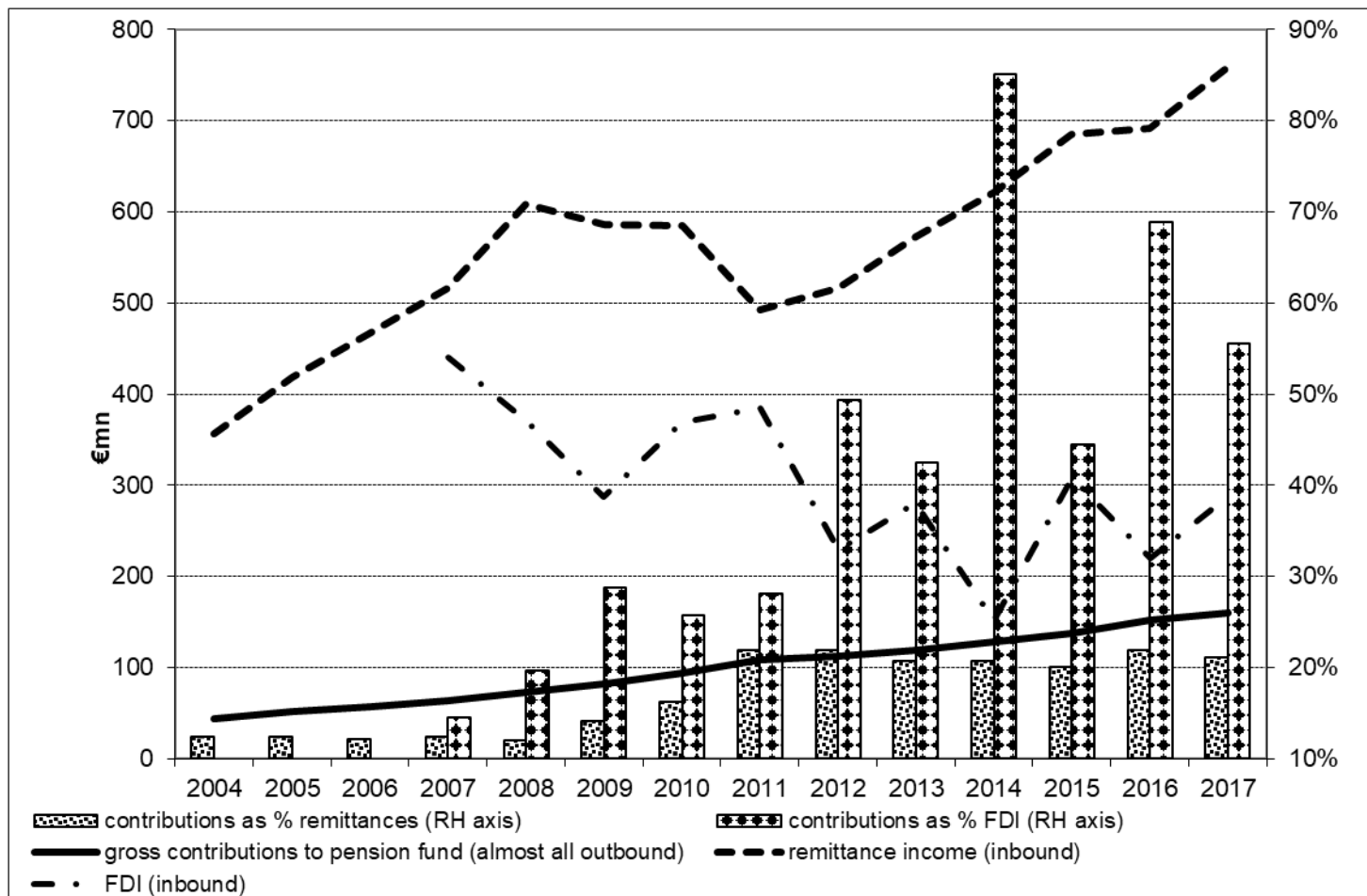
.... *a sine qua non*

Improve understanding of what ageing means

Take advantage of EU resources

Pension developments in SE Europe

The case of Kosovo



But: is this a case where the fallacy of aggregation holds?