Directions for the Reform of Pension Systems

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ABSTRACT

The paper presents approaches to the European Union, World Bank and the International Labor Organization regarding pension systems configuration. According to the European social model, the public pension system remains the basic protection of elderly, this allows Member States to maintain a degree of redistribution and solidarity necessary to provide adequate income to the elderly and to mitigate risks associated with private pensions. Original concept of the system based on three pillars have been extended so that the pension system supported by the World Bank consists of the combination of five basic elements with pillar 'zero', non-contributory form of 'social pension', which gives a minimum protection. International Labor Organization supports a pension scheme based on four pillars which comprise it have a pillar 'anti-poverty fund', based on means testing and financed from general revenues of the state.
Keywords: *reform of pension systems, multipillar system, flexibility, individualisation*

INTRODUCTION

Ensuring the welfare of older people and prevent poverty and social exclusion of these is an EU priority. The evolutions in population domains and demographic aging creates many concerns about financial sustainability of the pension systems, the European countries knew major reform of financing the retirement systems. The paper presents approaches to the European Union, World Bank and the International Labor Organization regarding pension systems configuration.

TRENDS AND OBJECTIVES OF REFORMING PENSION SYSTEMS

In addressing the demographic problem, the **European Union** supports the elimination of discrimination of older generations, continuous education throughout life, including the elderly, the creation of employment opportunities for people over 45 years, increasing retirement age and pension system reorganization. At the level of the European Union the equalization of retirement ages for women and men by 2020, at least 65 for both is settled.

In 2005 „Green Paper – "Confronting demographic change: a new solidarity between the generations" has established key priorities that the European Union must consider to cope with demographic change:

- Return to demographic growth. Thanks to the Determined implementation of the Lisbon Agenda (modernization of social protection systems, increasing the rate of female employment and the employment of older workers), innovative measures to support the judicious use of birth rates and immigration, Europe can create new opportunities for investment , consumption and the creation of wealth;
- Ensure a balance between the generations in the sharing of time throughout life, in the distribution of the benefits of growth, and in that of funding needs Stemming from pensions and health-related expenditure;
- Find new bridges between the stages of life: an increasing number of 'young retirees' want to participate in social and economic life. Study time is getting longer and young working people want to spend time with their children. These changes alter the frontiers and the bridges between activity and inactivity.

In the European social model, the public pension system remains the basic protection of elderly, this allows Member States to maintain a degree of redistribution and solidarity necessary to provide adequate income to the elderly and to mitigate risks associated with private pensions. The traditional classification of the pension systems include: Pillar I represented by the regulated pension schemes, mandatory, public or private; Pillar II, occupational regimes (occupational pensions), mandatory or voluntary and the third pillar represented by individual pension plans (The Social Protection Committee, 2005).

EU objectives on pensions are (European Commission, 2006):

- *adequate* pensions - providing adequate retirement income for all, access to pensions which allow individuals to keep living in retirement at a reasonable level, in solidarity and equity between and within generations, preventing social exclusion;
- *sustainable* pensions - financial sustainability of public and private pension schemes, given the pressures on public systems and in the context of the strategy to address budgetary implications of aging by: increasing the employment rate of labor support and extended working life active aging, balancing contributions and benefits in a fair and social manner, promote accessibility and security of pension schemes, tax policies including public debt reduction;
- *modernized* pension – insures transparent pension systems, well adapted to the needs and aspirations of women and men and the requirements of modern society and an aging demographic and structural changes, providing information necessary for the individual pension plans, the reform of pension systems based on the broadest possible consensus to adapt to flexible models of employment and career work.

A key element of the reform of European pension systems is flexibility in the transition from working life to retirement. This can be achieved through flexibility in terms of retirement age and appropriate incentives for working longer and also by partial retirement with opportunities to combine pension with salary (The Social Protection Committee, 2007).

Robert Holzmann and Richard Hinz (coord., 2005) consider that the possibilities of reform 'includes: (a) reforms that maintain the structure of benefits, public administration and unfunded nature of the system but changes key elements of the parameters (parametric reforms), (b) reforms that change the structure of benefits, but maintain public administration and the nature of the system (a nonfinancial or 'notional defined-contributions' NDC), (c) approaches that provide benefits fully funded (defined-benefit DB or defined contributions DC) under private management, (d) pre-financing public offering defined benefit or defined contribution, public administration (public system partially capitalized), (e) reforms to diversify the structure of benefits, administration and financing of the system (multipillar system)'. 'The relevant options for reform depend on country-specific considerations, especially the existing pension scheme (and other related public programs), the special reform needs of these schemes, and the (enabling or disabling) environment, such as administrative capacity and development of financial markets'. (Holzmann and Hinz, coord., 2005, p.9).

Even if one of the main motivations for radical reforms of pensions in many countries is reducing the state's role in providing retirement income, the introduction of private pension schemes does not mean the end of state responsibility. It should be noted the following issues: the role of state regulation and supervision of private pension systems, establish safeguards prescribed by law and tax incentives to encourage private participation schemes and social assistance system which occurs when the retirement income is inadequate (ISSA, 2003).

Noting the current trend of transition from defined benefit pension schemes to defined contribution pension schemes and the decrease of employer contributions , accompanying this trend, the European Parliament emphasizes the need for 'enhanced levels of participation and contributions of the employers to the current pension systems, to provide citizens with an adequate income in retirement' and 'constant need for appropriate contributions from employers, particularly defined contribution pension schemes' (Paragraph 36 of the European Parliament's resolution of November 20, 2008).

Increasing the real age of retirement and achieve higher rates of employment of labor requires action to: discourage early retirement (United Nations, 2008) and improving labor market opportunities of older workers (eliminating 'barriers' in the labor market, equal access to continuous learning and updating skills, attractive working conditions). To improve the rate of dependence in many Member States is necessary to increase women's participation in the labor market (in line with the Lisbon objective to achieve in 2010 an average of 60% to 51% in 2000) and to this end, providing childcare facilities (Council of the European Union, 2001).

Early retirement programs have negative effects on pension costs and the labor market through: the loss of productive capacity, wasting workers with experience, the retired deprivation of social contacts to early, risking the premature aging and increase the number of people socially dependent (Iovițu, 1997).

In order to set up pension schemes one should take into account that retirement decisions and also the preference for early retirement are related to the availability and generosity of pension benefits, but also by individual considerations such as health problems, negative attitudes of employers, age discrimination, rigid pay systems, lack of possibility of part-time employment, family care (Sørensen and Buhl, 2007).

Therefore, reversing early retirement trends requires a significant shift in socio-cultural patterns and individual preferences. For many people taking this decision, early retirement is seen as a good alternative to unemployment or is linked to various forms of dissatisfaction at work, even in the absence of disability or health problems.

The list of jobs and occupations where early retirement is possible can vary greatly between EU Member States and reflects the history of pension systems construction and cultural differences between countries. An option for all schemes recommended by the European Commission is to improve working conditions so that the nature of jobs be less harmful to workers' health and develop a more flexible approach to promoting retraining and changing careers (The Social Protection Committee, 2008).

In some countries, notably in Eastern Europe, the categories of disability were attributed to persons on the basis of disease severity with the main purpose of calculating benefits and less on the basis of reduced working capacity, taking into account the possibility of taking part on the labor market. Attitudes have changed considerably in recent years and although there are still some barriers to returning to practice, Member States have made good progress in the modernization of disability pensions schemes. Thus, many countries in the European Union have changed these schemes, making a more objective assessment of incapacity for work (eg. Slovakia), incorporating a variety of factors in the analysis (as in Great Britain), and focused, in some cases, the remaining work capacity (Netherlands), trying even to seek occupations or jobs matching the person (Hungary). A challenge for reform of these schemes is given by the reintegration of these people in employment, studies showing negative attitude of employers (The Social Protection Committee, 2008).

In the public pension system in countries like Austria, Germany, Sweden, 'disability benefits are granted as long as there is any possibility of rehabilitation. Giving priority to rehabilitation, these countries try to give pensions to those workers who are completely and irrevocably incapable of work' (Aarts and De Jong, 1999, p.20).

Many of the pension reforms put emphasis on individual choice, trying to ensure the accountable individual income in retirement. When he planned this income, each person faces risks from the labor market, with investment risk and inflation risk. If private pensions, individual choice is important and requires a good understanding of financial issues, to make choices in the then concerned. Thus, the European Parliament resolution of 20 November 2008 shows that the trend towards individualization help modernize pillars II and III and 'allow people, especially women and other vulnerable groups, benefit from greater freedom of choice and thus become more independent and able to aggregate their own supplementary pension rights' (paragraph 9).

However, the European Parliament considers that equality between men and women must be included among the objectives of social security system reforms, stressing that 'inequalities in the area are, in particular, indirect inequalities that are a consequence of the disparities that persist in the labor market salaries, career prospects and the unequal distribution of family and domestic responsibilities, and therefore can not be solved only by global action in May' (paragraph 11 of the European Parliament's resolution of November 20, 2008).

Findings of a study in 2008 of the Social Protection Committee of the European Commission confirms the trend towards an increased role for private pensions in the pension systems of the Member States of the European Union, while, as remarked in 2005, 'Systems PAYG public are expected to remain the main source of income of pensioners, especially for those earning' (The Social Protection Committee, 2008, p.56).

In 1994 the **World Bank** research report „prevent the crisis of the elderly - policies to protect elderly and promoting economic growth" suggested the development of three security systems together to achieve a co-insurance to the risks facing elderly. The three components which are covered by the report are: a compulsory public system financed from taxes, a private binding (personal savings or occupational pension) and a system based on voluntary deposits (World Bank, 1994).

The above-mentioned study identified three functions of financial security for older people to be taken into account in determining national security programs for senior citizens and referred to in support of multi-pillar system. They are:

- *saving* - facilitating personal efforts to transfer some of the revenue gained from working into old age
- *redistributive* function - transferring extra income to the elderly poor, avoiding intergenerational redistribution from poor to rich elderly
- *insurance* - protection against many risks that are particularly vulnerable older people (World Bank, 1994).

The report argues that the programs for older people should be both a social safety net and a tool for economic growth.

According to the World Bank, pension systems must provide *adequate* benefits (the level sufficient to prevent poverty in old age and age to replace the income of active period), to be *accessible* (on lending to individuals and society / government), *sustainable* (financially sustainable, both short and long term) and *robust*, i.e. able to withstand major shocks and to remain viable in the face of unforeseen circumstances (Holzmann and Hinz, coord., 2005, pp.55-57). The system concept based on three pillars have been extended so that the pension system supported by the World Bank consists of the combination of five basic elements: pillar zero, non-contributory form of ‘social pension’, which gives a minimum protection; first pillar - contributory system linked to wages, the second pillar, mandatory, essentially a savings account, the third pillar, voluntary arrangements may take various forms-individual, paid by the employer, defined benefit or defined contribution and the fifth element - support for the elderly, financial or non-financial, informal, interfamilial and intergenerational including access to health services and housing (Holzmann and Hinz, coord., 2005, pp.2-3).

The main options for reform are essentially three: the reform of the PAYG system, rapid and almost complete transition to the mandatory fund type and gradual transition to a multipillar system there is a combination of PAYG and components based on capitalization. This combination depends on ‘conditions of each country to launch the reform and financing constraints in transition’ (Holzmann, 1999, p.7).

The recommendations of an expert group (Visco, coord., 2005) on pension reform concerns include four types of policy intervention: providing incentives to postpone retirement and private pension systems development, development of financial instruments and associated facilities, improving prudential regulation and supervision of private pension systems, protection of pension beneficiaries and financial education. They must be completed but with others such as promoting an environment of financial stability and growth.

Robert Palacios and Edward Whitehouse believe that the success of pension reform depends on the following objectives: new system to provide a reasonable level of income for the elderly, the benefit to be consistent with long-term fiscal policy reform to improve efficiency of the economy. However, a well-conceived reform stimulates the development of private pension funds as financial intermediaries, added liquidity in the market, contributing to capital market development and has a positive impact on labor market (Palacios and Whitehouse, 1998).

In connection with secondary objectives of pension systems, a report prepared in 2006 by a group of independent evaluators recommended the World Bank to provide more realistic potential benefits of reform. This study found that following the reforms of pension systems in many countries assisted by the World Bank, multipillar systems ‘remained open to political influence’ and ‘secondary objectives such as growth, capital market development, improving labor flexibility remained largely unfulfilled’ (Andrews, 2006, p.30).International Labor Organization’s recommendations on pension reform concerns: extending coverage to all members of the public, providing protection against poverty, income replacement, regular adjustment of benefits, taking account of inflation or rising living standards, creating a favorable environment for development voluntary supplementary pension schemes (Fultz apud van Ginneken, 2004). To achieve these goals, I.L.O. promote: equal treatment in employment, both migrant and domestic workers and women and men, democratic management and accountability of state pension systems to ensure that the conditions of the pension protection (Van Ginneken, 2004).

According to specialists (Fultz and Ruck, 2001) interest in the reform of central and eastern European countries due to the pension system 'inherited' and the impact of transition, the problems identified are: determining the role played by the state retirement age reduced transparency than the collection and allocation of resources, weak link between contributions and benefits, increased dependency ratio, the granting of privileges for certain occupations, the decline in employment, decreased number of taxpayers and non-payment of contributions by companies.

International Labor Organization supports a pension scheme based on four pillars which comprise it have a pillar 'anti-poverty fund', based on means testing and financed from general revenues of the state. Universal coverage and governance are considered two major problems of pension systems. Many states are unable to apply the principle of universal coverage because of social groups in the informal sector labor market. With regard to structure benefits of pension schemes, 'the general objectives must be considered in the form of five components: the extension of coverage to all members of the population, protection against poverty in old age, during disability, or on death of the wage earner for all members of the population, provision of an income, in replacement for earnings lost as the result of voluntary or involuntary retirement, for all those who have contributed, adjustment of this income to take account of inflation and, at least to some extent, of the general rise in living standards, creation of an environment for the development of additional voluntary provisions for retirement income' (Gillion, coord., 2000). In addition to this there are other considerations: the principle of compulsory affiliation, equal treatment between women and men and between nationals and non-nationals, the need to provide guaranteed benefits and expected at least to a certain level, democratic management pension system, by including representatives of workers and employers on the controlling body, the responsibility of the state to ensure that the conditions for the delivery of benefits is fulfilled (this does not mean that the state is obliged to make this work), setting ceilings of benefits and contributions (Gillion, coord., 2000). The reforms of pension systems in the world are needed to ensure sustainability of PAYG systems but it is 'just a part of the equation'. Pension reform must be linked to changes in behavior and attitudes of all stakeholders in promoting a longer working life (OECD, 2003).

As highlighted by international documents, the use of work capacity of older people in full measure would result in a threefold effect on the sustainability of pension systems: the goods and services produced would contribute to economic growth, retirement should be postponed and social contributions and taxes tax would increase the funding of pensions and other social benefits. In addition, international comparisons show that, at the macroeconomic level, the restriction offers employment for older people does not improve employment prospects for young people, but may reduce total employment of labor, generating an additional cost for social protection systems (The Social Protection Committee, 2008).

CONCLUSIONS

Regardless of the model supported, the recommendations of the three organizations seeking to create financially sustainable pension systems, ensuring a minimum income and improve social protection of the elderly. Increasing the retirement age, incentives for working longer, restrictive conditions for early retirement and disability pension and development of private pension systems are some of the main principles of reform pension schemes. It should not be overlooked importance of specific situation in each country (which determines that a specific choice of system), financial education of citizens and the role of state in pension schemes.

The supporting of pension system by multi-pillar allow diversification of pension income and increase social protection of persons. The success of multipillar system requires, among other things, a real fiscal discipline and involves a good correlation of the actions of the labor market with the capital market.

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