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World Bank: Pension Reforms Needed in Emerging Europe and Central Asia to Protect Future Generations

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Countries struggle to meet pension needs of their aging populations
The profound effects of aging populations and a shrinking labor force on overstretched state pension schemes in emerging Europe and Central Asian countries demand significant reforms, says the World Banks new report The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia. If bold pension reforms are not made, it will be todays young and the elderly poor who will suffer the most from the inability of state pension systems to ensure basic income protection in old-age. Failing to act today raises equity concerns for the next generation as it would likely result in future pension benefits cuts and these would hurt the poor more than the rich, according to the report.
The report, launched today in Brussels at a conference hosted by the European Commission and the World Bank, finds that most pension systems have already reached "maturity, with little possibility to expand the number of contributors due to a stagnant and declining working-age population. The declining working-age population is causing the traditional population pyramid - with a few elderly at the top and larger numbers of working-age populations at the bottom - to invert, with smaller working-age populations now at the bottom and larger numbers of pensioners toward the top.
"The countries of emerging Europe and Central Asia have been some of the most active reformers in the world, adopting a number of new pension designs, such as point systems in Serbia and Croatia, notional accounts in Latvia and Poland, universal benefits in Georgia, Kazakhstan, and Kosovo, and individual savings accounts in Estonia, Romania, F.Y.R. Macedonia, and the Russian Federation, said World Bank Vice President for Europe and Central Asia, Laura Tuck. "However, many of these reforms have not been sufficient for pension systems to sustain adequate benefit levels in the face of deep demographic changes. Moreover, some of these reforms have been reversed in the face of short-term fiscal pressures.
The report states that transition countries of Europe and Central Asia, including Turkey, have made big efforts in the past 20 years to reform their pension systems in order to align them with the new social and economic realities of market economies. However, with the high economic growth of the mid-2000s, some countries increased the generosity of pension benefits in light of their higher revenues. The financial crisis left these countries with reduced revenues and higher pension benefits, which led to pension reforms reversals. For instance, some countries undid the individual savings accounts to help fill their revenue shortfalls, but at the risk of further compromising the sustainability and adequacy of pensions in the long run.
"Pension systems can no longer promise to provide ever more generous benefits to the ever-increasing number of pensioners. Increases in life expectancy, sharp declines in fertility, and increasing emigration have contributed to compromise the affordability of many pension systems, said World Bank Vice President for Poverty Reduction and Economic Management, Ana Revenga, in her opening remarks at the event. "The report examines a range of solutions and concludes that the public pension system will have to prioritize the provision of basic pensions, coupled with measures to encourage longer working lives and individual own savings.
Reforms need to ensure that the elderly do not fall in poverty by providing a minimum pension benefit. This has implications for the way pensions are currently financed.
"Changing the financing mechanism for old-age security has implications for who gets benefits and how much they get, said Anita Schwarz, a Lead Economist in the World Banks Europe and Central Asia region, and one of the principal authors of the report. "Right now, countries often limit pensions to those who have contributed, and link the benefits they receive to what they have paid in. But all elderly need some form of old-age income support to maintain a dignified living standard. This raises the need to look for financing sources other than labor taxes.
The report examines two potential solutions to face the demographic challenges to pension systems: generating additional fiscal revenue to cover pension deficits, and increasing the number of contributors to the system. However, countries in the region tend to already have high tax burdens, especially on labor, leaving them little scope for generating additional revenue to address pension deficits. Moving away from labor taxation as the financing source for old-age security and toward consumption and property taxes might help generate some additional revenue, but even there the scope is limited in most countries.
Expanding the number of contributors is not a panacea either. In most of the countries in emerging Europe and Central Asia, most prime-age adults, those aged 35-44, are already working. The space to expand the labor force lies in the older populations, fewer of whom are working when compared to other regions of the world. Moreover, expanding the base of contributors can only ease or delay needed reforms of pension systems if the relationship between contributions and benefit accrual remains fundamentally flawed.
"One of the more striking findings in the report is that expanding the number of contributors ? by bringing in informal workers or the growing influx of immigrants ? helps the pension system in the short-run when it receives additional revenue, but makes things worse in the long-run when pension benefits have to be paid to even more retirees, said Omar Arias, a Lead Economist in the World Banks Europe and Central Asia region, and a principal co-author of the report. "Formalization and immigration might help buy time for governments to make the needed adjustments to pension systems, but neither of them will achieve the twin objectives of adequacy and sustainability of pensions in the long-run.
While both additional revenue and increased labor force can contribute to mitigate short-term adverse impacts of unavoidable pension reforms, the long-term solution might lie in adjusting the generosity of pension systems so that retirement income covers only the period when individuals can no longer work, typically the last 15 years of life. This is what was afforded to retirees in the 1970s, compared to an average of 18 years of retirement for men and 23.5 years for women in many countries today.
Raising retirement ages and encouraging and supporting individuals to work longer would go a long way toward enabling pension systems to provide for basic old-age income and be more financially sustainable.   Measures to encourage older workers to continue working include:
- providing options for gradual retirement, for example, by allowing older people to work part-time while collecting a partial pension;
- adopting small adjustments to the workplace, such as putting magnification on computer screens and providing ergonomic chairs, to raise the overall productivity and comfort level of older workers; and
- investing more effectively in training at older ages by rethinking adult education, training, and lifelong learning systems to make them a better fit for aging brains.
Finally, fiscal pressures are leading countries to increasingly limit their already-overstretched pension spending by fostering private pension provision and individual long-term savings plans. Savings allow workers to have additional retirement resources available. Measures such as automatic enrollment in savings schemes can induce workers to fill any gap in retirement income with their own savings.
There are no one-size-fits-all solutions. Regardless of the path chosen, countries need to begin a social dialogue on what approach is best suited in each country context to preserve the ability of pension systems to provide basic income protection in old-age for todays young and the less well-off elderly in the face of their demographic challenges.

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