# SOCIAL PROTECTION AND REDISTRIBUTION

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This paper makes several comments on the current state of social protection systems in Central and Eastern Europe - in part stimulated by the presentation made by Mr. Héthy.

The level and scope of change of social protection systems has by no means been uniform across the region. Some countries have experienced a significant upheaval of their social protection systems, with social benefits being considerably reduced. Others, and here we might include Slovenia, have undergone remarkably little change and the level of social benefits - pensions, health care provision, unemployment benefits, maternity leave etc. - has remained fairly stable throughout the transition period. There was a price to be paid for this "stability"; in Slovenia social security contributions have remained quite high during the period 1991-1995 and the total social security contributions (employee and employer parts) amounted to some 44.7% of gross wages. The contribution rates were significantly reduced in 1996; this of course represented only a shifting of the burden, with the state budget covering the gap between social security revenues and social security expenditures by means of large transfers to the National Pension Administration. These transfers represented some 20% of total revenues of the National Pension Administration in 1997. Though large transfers from the central government budget are not sustainable in the long run, the developments in the social protection system of Slovenia show that severe reductions in social benefits are not "the only game in town".

Most of the underlying causes of the financial crisis in social protection systems in Central and Eastern Europe are known and are well presented in Mr. Héthy's paper, the most important being without doubt the severe drop in the number of contributors (employees) and a large increase in beneficiaries - pensioners, the unemployed, etc. Thus, for pension contributions in Slovenia, the contributor/beneficiary ratio has decreased from 2.3 in 1990 to only 1.6 in 1996. These changes were - as also stated by Mr. Héthy - a consequence of fundamental changes in economic and political systems - with a concomitant sharp drop in GDP.

Can anything be done to cure social protection systems and restore their financial balance and "sustainability"? This is a topical theme which is being expounded at numerous seminars, conferences and symposia. On top of this discussion agenda has been the reform of the pension system because pensions in most European countries account for at least 40% of all social protection outlays. Reform proposals have very much centered around ideas for a multi-pillar system, with the introduction of the second pillar (mandatory saving for retirement managed by private pension funds) being the most debated reform proposal. It has been sternly advocated by the World Bank and the second pillar in the form of mandatory saving schemes is currently being implemented in two Central European countries, Poland and Hungary. It seems that some other countries, such as the Czech Republic and Slovenia, have adopted a “wait-and-see” approach. This reticence stems from the fact that such a fundamental reform is not problem-free. It involves very real short-term fiscal costs but, in the opinion of some, uncertain commensurate long-term benefits.

Is the fundamental reform of the public pension system the only viable alternative and could it be that countries which have adopted a procrastination approach (with regard to fundamental reform) stand to loose? This cannot be answered with certainty; one can though observe that insufficient attention has been given to the possibility of reforming the existing public pension system without the “upheaval” and radical reform implied by the introduction of a new mandatory savings pillar. It is my view that the radical proposals had a fertile breeding ground in the existing state of the public pension systems which are characterised by massive contribution evasion and strategic manipulation by various groups. In countries where the public pension system is functioning satisfactory, there is - in my view- no particular pressing need for sweeping reform. Reform could be confined to the first pillar where a closer link, statistically speaking, between contributions and benefits could be established. This in turn would ensure a high and stable degree of public acceptance and support.

Would this course of action, namely putting emphasis on the insurance role of the public pension system, downplay the redistributive role of the public pension system? The answer to this question is yes. But I believe that an emphasis on the redistributive role, i.e. solidarity, is misplaced since it would change the nature of the existing social insurance system and move it away from the social insurance concept. Namely, social insurance systems in continental Europe encapsulate both the insurance and solidarity (redistributive) principle with the blend of these two differing among countries. By stressing the redistributive role of social insurance systems (and the public pension system in particular), these systems would very clearly be marginalised and “doomed” since they would most probably lack the steady and strong support of the body politic which is essential for the viability of such systems.

All this does not mean that the redistributive role of the public pension system is unimportant, clearly it is. But the insurance principle ought to dominate whereas it seems that even the redistributive role of the present social protection system has been vastly exaggerated. Recent research in Slovenia has shown that its public pension system does not provide any clear redistribution patterns.

On the visible front, there are certain features which imply redistribution (such as the ceiling on pensions but none on contributions), but taking account of the actual longevity risk, the direction of redistribution is not quite clear since poorer and less educated pensioners tend to live much shorter lives than richer and more educated pensioners. This can be observed from Tables 1 and 2 which show how deceased old-age pensioners differ markedly in educational level attained and average pension - in comparison with the total old-age pensioner population.

**Table 1 - Comparison of average educational levels (measured in years of schooling) for all Slovenian male pensioners in 1996 against that for those who died in 1996.**

| Age cohort | All male pensioners (years of schooling) | Male pensioners who died in 1996 (years of schooling) |
|---|---|---|
| **51-55** | 9.31 | 8.78 |
| **56-60** | 9.79 | 9.08 |
| **61-65** | 9.63 | 9.37 |
| **66-70** | 9.73 | 9.14 |
| **71-75** | 8.72 | 8.59 |
| **Over 75** | 8.71 | 8.23 |

*Source*: Datafiles from the National Pension Administration of Slovenia

**Table 2 - Comparison of average monthly pension (in thousand tolars) of all Slovenian male pensioners in 1995 against that of those who died in 1995.**

| Age Cohort | All male pensioners (monthly pension in ‘000 tolars) | Male pensioners who died in 1996 (monthly pension in‘000 tolars) |
|---|---|---|
| **51-55** | 87.1 | 69.0 |
| **56-60** | 75.1 | 57.7 |
| **61-65** | 72.4 | 56.5 |
| **66-70** | 72.9 | 55.5 |
| **71-75** | 74.9 | 53.3 |
| **Over 75** | 74.5 | 57.2 |

*Source*: As for Table 1.

While the differences in educational level attained (Table 1) are significant, the differences in average pensions (Table 2) are even more striking. It is quite obvious that education and income are important "explanatory variables" for longevity risk. Less educated - and poorer - pensioners live shorter lives than pensioners with more education and higher incomes.

A sensible and defensible strategy for the reform of the public pension system for those Central and Eastern European countries which are still "sitting on the fence" and undecided as to their favoured course of pension reform would be to purge the system of layers of privileges and perks for various groups of contributors and ensure a greater role for the principle of horizontal equity. This means the equal treatment of persons who are in an equal position regarding their pension contributions. This would guarantee greater coherence of the system and also greater discipline in collecting contribution payments.

Such a reform would not be a total panacea and once-and-for-ever solution. Because of poor demographic prospects, a continuous "monitoring" of the public pension system would be necessary in order to prevent the system from derailing - as has happened in several countries in transition. The troubles that have occurred in the social protection systems in Central and Eastern Europe can also be traced to tax and contribution evasion which has reached epidemic proportions in some countries. It is a naive belief that a move from the public system would improve the tax and contribution collection discipline - as the experience of Chile has shown. The problem of fiscal revenue gap due to non-payment of taxes and contributions is difficult to resolve since there are no quick fixes and improvements tend not to be spectacular but rather incremental. Unfortunately, this problem must be tackled by central government and cannot be circumvented.

Privatisation and reliance on non-governmental organisations for certain forms of social provision ought not be neglected; the state and social insurance systems cannot and should not be omni-providers. A sensible move toward private provision would appear justified, but this shift can also be picked up by various insurance or saving schemes at the individual level. Entrance and participation in these schemes (be they schemes for supplementary pension provision or supplementary health insurance) would be on an individual and voluntary basis. That a sensible move toward private provision is warranted can also be supported by changes which have occurred in the economic sphere. In other words, the development of a modern market economy must be followed by compatible developments in the social sphere. The disagreement among experts is not about whether social reform is necessary, but on the necessary scope of change. How far should the role of the state be circumscribed and what degree of burden, risk and responsibility should rest with the individual.