

SECTION 2. INITIAL POLICY RESPONSES BY COUNTRIES TO THE GLOBAL CRISIS

Hit with an abrupt shock to the fiscal position of the public pension scheme, countries started considering and implementing policy changes across the key pillars, as shown in Table 3. The immediate concern was improving the fiscal balance, by generating additional resources for the public pension system or by cutting expenditures. However, policymakers need to be aware that measures that generate short-term gains may involve additional costs in the long run.

A few countries, such as Romania and Russia, reversed recently introduced cuts in contribution rates. The rate cuts had been intended to reduce labor costs and to foster formal labor market participation, but were reversed in light of the crisis and need for revenue.

Some of the second pillar countries, including Estonia, Latvia, Lithuania, and Romania reduced contribution rates in the second pillar, while increasing them in the first pillar. In the case of Romania, they delayed a scheduled rise in second pillar contribution rates. Temporarily of course this raises revenue and alleviates some of the current shortfall, but workers will now see reduced balances in their second pillar accounts at retirement and consequently lower pensions. Since they made higher contributions to the public system, they will expect the public system to finance higher first pillar pensions to compensate for the reduced second pillar pensions. The fiscal impact of this long-run, short-run trade-off depends on the particulars of each pension system, the extent of the contribution change, and the duration of the change, but is unlikely to be favorable for either the Government or the individuals.

Other countries are allowing, or considering allowing, individuals who chose a combination of first and second pillars to switch back to a first pillar only option. Countries in this group include Hungary and the Slovak Republic. Like reducing contribution rates to the second pillar, this measure generates additional revenue

Table 3: Policy Actions in ECA Countries – Legislated and Considered in Response to the Global Economic and Financial Crisis

(a) Policy Action	(b) Legislated	(c) Considered
Change in Overall Contribution Rate	<p>-Romania: From 27.5% in 2008 to 31.3%.</p> <p>- Russia: From 20% to 26%, and moving contributions from basic pension to NDC pension.</p> <p>-Macedonia*: Gradual reduction of pension contribution rate starting from January 2009 (2008 - 21.5% , 2009 - 19%, 2010 - 16.5% and 2011 - 15%) and payment of contributions based on gross wage (including bonuses etc) instead of net.</p> <p>- Montenegro*: From 21% in 2008 to 20% in 2010</p>	<p>Bulgaria*: From 23% to 21% in 2010 and then gradually to 18% by 2013</p> <p>Lithuania: To be increased by 2% starting in January 2010.</p>
Adjustment to Second Pillar Contribution Rate	<p>-Romania: Contribution rates to the 2nd pillar frozen at 2% (instead of legislated increase to 2.5%)</p> <p>-Lithuania: Contribution rates to the 2nd pillar reduced from 5.5% to 2% in 2009 and 2010, to go to 6% for 2012-2014.</p> <p>-Estonia: Diverting full 2nd pillar contributions to 1st pillar in 2009 and 2010; moving back to 2% contribution from mandatory rate in 2011 and 4% in 2012, with the possibility of higher 2nd pillar contributions of 6% in 2014-17 to compensate for the current reductions.</p> <p>-Latvia: Contribution rates to the 2nd pillar reduced from 8% to 2% in May 2009; increasing to 4% in January 2010 and to 6% in January 2011 and remaining at this level (2nd pillar contribution rate was to rise to 10% in 2010 prior to the amendment)</p>	.
Allowing Opting	- Slovak Republic: First option (Jan –June 2008) and second	

(a) Policy Action	(b) Legislated	(c) Considered
in/out of Second Pillar	<p>option (Nov 2008 – June 2009) to switch in/out of the second pillar.</p> <p>-Hungary: Those who were older than 52 on December 31, 2008 will be allowed to switch back to the first pillar only until December 31, 2009.</p>	
Making Second Pillar Voluntary to New Entrants	-Slovak Republic: Second pillar participation for new participants voluntary as of January 2008.	
Changing Indexation/ Minimum & Basic Pension/Benefit Cuts	<p>-Serbia : Suspension of indexation for 2009 and 2010 with return to legally mandated inflation indexation beyond 2010 per Government agreement with the IMF</p> <p>--Hungary: Abolishment of 13th pension; indexation to be between Swiss or pure inflation indexation depending on the GDP growth as follows (i) GDP growth < 3%, 100% inflation; (ii) GDP growth between 3-4%, 20% wages, 80% inflation; (iii) GDP growth between 4-5%, 40% wages, 60% inflation ; and (iv) GDP growth >5%, Swiss indexation.</p> <p>- Croatia: Suspension of indexation in 2010</p> <p>- Latvia: First pillar benefits cut (non-working beneficiaries 10%; working beneficiaries 70%)</p> <p>- Macedonia: Pension indexation at 20%-50% gross wage –CPI indexation from July 2009 to December 2009; will go back to 50%-50% gross wage-CPI indexation starting January 2010.</p>	<p>-Latvia: Elimination of wage indexing of contributory pensions.</p> <p>-Estonia: Changing indexation if negative growth or first pillar deficit more than 1% of GDP</p> <p>-Romania: Moving from wage to inflation indexation.</p> <p>Ukraine: Suspension of indexation in 2010.</p> <p>- Moldova: Suspension of indexation in 2010</p> <p>-Lithuania: Benefit cuts (regular pensions based on progressive scale between 3.3% -12.4% -on average by 5%; state pensions-non-contributory pension supplements for police, military, victims of repression, special recognition pensions-between 5% -20%; pensions for non-working beneficiaries in addition be reduced based on their wage income from 2.5% to 50%) starting in December 2009.</p>
Increase in Retirement Age	-Hungary: Increase in retirement age from 62 to 65 by 2012.	<p>-Ukraine: Increase in retirement age to 62 for both men and women</p> <p>-Romania: Equalizing retirement age of women with men at 65.</p>

(a) Policy Action	(b) Legislated	(c) Considered
		<p>-Croatia: Increase in retirement age for women to 65</p> <p>-Poland: Increase in retirement age for men and women to 67 by 2030.</p>
<p>Measures to Address</p> <p>Early Retirement</p>	<p>-Poland: Elimination of numerous early retirement schemes (previously available to some 1 million people) .</p> <p>-Hungary: Increase in penalties for early retirement and introduction of bonuses for delayed retirement.</p> <p>-Latvia: Reduction of early retirement pensions from 80% of normal retirement pension, to 50% of normal retirement pension. Early retirement will no longer be an option from January 1, 2012</p>	<p>-Ukraine: Gradual elimination of special and early pension regimes</p> <p>-Romania: Elimination of special pension schemes and early retirement</p>
<p>Guarantees of Second Pillar Contributions</p>	<p>-Kosovo: Guaranteed nominal value of contributions for those retiring in late 2008 and 2009</p>	

**Montenegro and Bulgaria continuation of earlier policy decisions; Macedonia to account for the increased wage subject to contributions.*

for the first pillar, but this measure is more extreme, maximizing both the extent of the change and its duration. Allowing transition cohorts, in particular those close to retirement to switch back to the first pillar yields immediate revenue gains for the first pillar and may provide more secure benefits for those about to retire when asset values are particularly low. But extending this option to younger cohorts and new entrants risks creating (i) additional uncertainties for government finances as future revenues and expenditures depend on future individual choices, (ii) additional uncertainties for the pension fund market since future market size now becomes unpredictable, (iii) political pressure to allow first pillar participants to switch back to the second pillar if asset values rise sharply, (iv) more uncertainty for individuals from the reduced diversification in their old age incomes, and (v) higher fiscal costs in the future.

An additional group of countries has changed or is considering changing indexation. These include Serbia which has frozen pensions in nominal terms in both 2009 and 2010 in response to the declining revenue. No countries have actually reduced nominal pensions even when the legal indexation required reductions in response to falling nominal wages.

In many countries, second pillar pension funds have reacted to the drop in financial asset prices by moving out of equities and into fixed income instruments. However, this amounts to unnecessarily capitalizing the losses in the pension portfolios and in losing the opportunity for capital gains when asset prices recover. Since pension funds are long term savings, they should focus on long term performance and avoid panicked attempts to time the market.