Social Protection is a collection of measures to improve or protect human capital, ranging from labor market interventions and publicly mandated unemployment or old-age insurance to targeted income support. Social Protection interventions assist individuals, households, and communities to better manage the risks that leave people vulnerable.
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Human Development Network Gets New VP

Eduardo Doryan, a former Minister of Education in Costa Rica, is the new Vice President for the Human Development Network (HDN) of the World Bank of which Social Protection is a sector. Eduardo Doryan’s ambition is to change the rules of development. “Over the last decade, economic policies have not been targeted explicitly toward positive impacts on human development. They are today, and part of my job is to contribute to the paradigm shift which has been led by the World Bank,” says the new VP. The 47-year old Costa Rican served as his country’s Minister of Education from 1994 to 1998 and as Deputy Minister for Science and Technology from 1986 to 1990. Before joining the Bank he was Director for the Latin American Center for Competitiveness and Sustainable Development at INCAE, an international graduate school in Latin America. He earned his M.P.A. as well as a doctorate in Political Economy and Government from the John F. Kennedy School of Government at Harvard University.

SP Project Wins Big at Development Market Place

The SP Project “Changing Minds, Policies and Lives—Ending Institutionalization in ECA” was a big winner at the Development Marketplace competition that took place in the World Bank’s Headquarter in Washington D.C. in the second week of February. Not only did the jury award the project with $180,000 for its implementation, the project was also a favorite of the audience and won a People’s Choice Award (3rd place) for “Tackling Taboo Subjects.”

The Award Ceremony was culmination of the two-day competition sponsored by the Bank and partners to identify and award the most innovative ideas for reducing poverty. At the ceremony World Bank President James D. Wolfensohn announced 44 winners of a total of $5 million. 339 proposals were in the final competition.

The winning SP-project was proposed by Louise Fox (HDNVP) and Aleksandra Posarac (ECSHD), in partnership with UNICEF EURO (Dita Reichenberg). Pamela Dudzik (HDNSP) led the preparation of the marketplace exhibit. The project is a campaign to promote welfare system change—from institutions to community-based services for orphans, disabled people. This is an urgent social protection issue in the ECA region.

Today 1.3 million children, disabled, and elderly in ECA live in large, inhume institutions. If community-based alternatives were available, up to 80% of these individuals would live at home, with their families.

The winning project is a bottom-up campaign that will support change. An information and communication center (electronic link) will meet needs of NGO and public change agents by facilitating mutual support and disseminating information on good models and strategies. Technical support groups will identify solutions to emerging problems in implementing national standards and will develop toolkits.
2000—The Challenges Ahead

2000 is going to be a busy year for the Social Protection Sector. End-February we are launching our Pension Primer at the World Bank’s Human Development Week in Washington D.C. To highlight this important event, we have chosen to let this issue focus on our work in the pension area where we are facing one of the big challenges of the new millennium: how to include the two-thirds of the workers of the world, which today are not covered by any formal pension system to secure them in old age.

The Pension Primer is intended to become a powerful tool for everybody who is working with pension reform processes. The Primer will make the World Bank’s cutting edge research papers and hands-on reform experience available on-line. As the primer will be updated continually, it will always be the place to look first for latest developments in pension reforms.

But Social Protection is more than pensions. Later this spring the final version of the new Social Protection Strategy Paper is scheduled to be presented to the World Bank’s Executive Board of Directors. The new strategy introduces Social Risk Management (SRM) as the new definition and conceptual framework for Social Protection. The main idea behind SRM is that all individuals, households and communities are vulnerable to multiple risks from different sources and that social protection should work not only as a safety net, but also as a springboard for the poor. With the new framework we want the world to take a fresh view on social protection as an investment in human capital formation rather than the traditional view of it as a cost. You can be sure to hear more about all this in the upcoming issues of SPectrum.

Another event in the near future that we are looking forward to is the Global Children’s Week 2000 which will also take place here in Washington D.C in April. This will be an important step in the work to protect children better and in the fight against harmful child labor. In June, Social Protection, in a joint effort with the World Bank Institute and in collaboration with our partners in the regions and in the social fund networks, will host an international conference on social funds. We expect this conference to be a milestone in the on-going discussion on social funds that will help forge consensus on future directions for social funds in the 21st century.

As you can hear, the Social Protection Sector intends to keep its profile as high as ever in 2000 and you will be able to read all about in SPectrum. This is the second issue of SPectrum and I would like to thank you for the overwhelmingly positive response we received on the first issue. I am happy to announce that the Social Policy and Community Social Services Development Project, we reported on in that issue has been selected to be presented at the World Expo 2000 in Hanover, Germany this summer.

Enjoy your reading. If you know anybody whom you believe would like to receive SPectrum, please let us know and we will be happy to send him or her a copy. And please remember that we still are very interested in your response and that we welcome ideas and letters to the editor.

Yours truly,

Robert Holzmann
Why Newborns Should Worry About Pensions

The first millennium baby was born in Waitakere Hospital in New Zealand at one minute past midnight. But of the 355,000 children born on 1 January 2000, eight out of every ten came into the world in a developing country.

These children can expect a much better life than their parents or grandparents. It will be longer, for a start. Millennium babies in middle-income countries can expect to live to 73. When their parents were born, their life expectancy was less than 65.

The year 2000 generation will also probably have a better standard of living, better health and more leisure time. Two generations ago, nearly everyone in developing countries worked until they died. So fewer than one in ten over 65 in the 1950s were not working. A generation ago, three out of ten people in this age group were ‘retired.’ Now, with the millennium baby’s grandparents nearing old age, half or more of the over 65s have stopped working in developing countries.

Year 2000 children will have fewer siblings than their parents. Mother and father come from families of five or six on average, while they will probably have only two or three children themselves.

Fewer babies and longer lives lead inevitably to an ageing population, the effect popularly dubbed the ‘demographic time-bomb’. Currently, only one in twenty people in developing countries is over 65, and this figure was still lower when millennium babies’ parents and grandparents were born. By the time they reach age 65, the old will make up one in five of the population. The transition from a young society to an old one took a century and two or more decades in Europe. But in developing countries, the shift will be much faster: as little as three decades.

Ageing will have profound social and economic effects. One of the largest and most obvious is on the pension system. Most public pensions were introduced in the late 1940s or the 1950s. So the millennium babies’ grandparents are the first generation to have the whole of their working lives affected by the pension system as both contributors and beneficiaries.

This first generation typically does very well as a result of the pension system. Pension contributions were not particularly burdensome because there were few elderly when this generation was working. And the working population was still growing for all or most of their working life, so the cost of paying for pensions could be spread across more people. As a result, the benefits they can expect to receive can be many times the amount of contributions they paid. Put another way, they earned a return on their contributions of 20 per cent or more a year.

The millennium babies’ parents will not fare so well. With the numbers of elderly increasing, their pension contributions have been higher than their own parents’ were and will increase between now and retirement. So the amount paid in is much closer to the benefits paid out than for the previous generation. The pension benefit might be equivalent to a five per cent or so return on contributions.

Now the millennium babies’ pensions. Contribution rates are going to be much higher, because they will have to pay for longer-lived parents and grandparents’ pensions. And, with fewer millennium babies than born in previous generations, the burden is spread less thinly. Their return on pension contributions could be as high as two per cent a year. But often it will be zero, or even negative in countries that are ageing rapidly. We can add up the contributions millennium babies can expect to pay and the benefits they can expect to receive. The effect, in many countries, is as if the millennium baby received, at birth, a bill of thousands of dollars.

The great irony of public pension systems is that they are set up to help workers overcome their short-sightedness but politicians often suffer from their own myopia. They make promises that don’t come due until they are out of office when it becomes someone else’s problem. Meanwhile, the millennium babies are not able to object to the promises that they will have to finance when they grow up.

People sometimes take the snapshot view of pension systems—focusing only on what is happening in the present. But for pensions long term thinking is needed. Public pension schemes are long term commitments that imply a kind of intergenerational contract. The World Bank’s goal is to protect the most vulnerable elderly and facilitate savings for retirement in a way that can be sustained not only next year, but for the next hundred years. Hopefully we can reduce the millennium babies’ large bill for pension provision and give them a better birthday present.

Technical Note
The figures quoted in this paper do not relate to any specific country or region. However, they are representative of the experience of a range of middle-income countries.
Change of presidents, governments, and other obstacles did not stop the Polish Pension Reform Process.

When 95 percent of the members of the Polish Parliament in August 1997 voted for the first part of the Polish Pension Reform package, it was the outcome of discussions that had started back in 1989. However, not much happened in the first years of transition, as more urgent tasks were on the agenda. In December 1998 a second part of the reform package was passed in the new parliament and in January 1999 the great day came: the reform became reality. Through an extraordinary act of leadership and commitment displayed by the three successive plenipotentiaries and the appointed experts, the reform had survived change of both governments and parliaments without losing broad support.

World Bank economist Michal Rutkowski led the team of experts that was behind the reform. Today he calls it an extraordinary time of his life. “The Bank reacted to the Polish government request, and allowed for my secondment to Warsaw in mid-1996. Subsequently, the Bank played a pivotal role in forming an innovative consortium of donors involving also UNDP, USAID, European Union, SIDA, CIDA, Know-How Fund, and several smaller bilateral donors. We would not have made it without this assistance, which supported the work of the best Polish professionals. This was the Bank at its best and it is difficult not to mention the key role played by Ralph W. Harbison who was then a division chief responsible for social protection in Central and Eastern Europe.”

In the spring of 1996, on the eve of the start of the real work on the reform, three broad outlines were on the table. The first one was close to the Chilean pension reform and developed in the Ministry of Finance by Marek Mazur, adviser to the deputy prime minister and minister of finance G.W. Kolodko. The second one, developed by the “Solidarity” trade union, was also based on the idea of mandatory pension funds, but with different institutional solutions. The third one was developed in the Ministry of Labor and Social Policy and it was just a plan for limited reform of the old pay-as-you-go system with a marginal role for the funded pillar. It so happened that the third proposal gained the status of the official one and was submitted to the parliament for approval.

And then the change came. A new government took over in February 1996 and when the Ministry of Labor’s reform proposal was debated in Parliament in April 1996, a new Prime Minister, W. Cimoszewicz, and a new Minister of Labor and Social Policy, A. Baczkowski, a reformer at heart, were in office. Both of them, as well the minister of Finance Kolodko, knew that the proposal was insufficient. They also knew that public opinion research showed the Ministry of Labor’s plan was perceived as conservative and that people wanted a more decisive reform. Baczkowski was designated plenipotentiary with regard to pension reform. He was chosen because he held a unique position in the government because he had originally been a member of the Solidarity and was highly respected by both the left and the right. He had also during his time in government in 1992 demonstrated excellent negotiating skills and in 1994 he had been appointed chairman of the tripartite commission on socio-economic affairs.

As plenipotentiary Baczkowski began working on a completely new reform program. He asked for Rutkowski’s secondment from the World Bank and charged him with assembling a team of Polish top experts to work out very quickly a top quality reform proposal. Rutkowski and his deputy Marek Gora, a well-known labor economist, led the team that worked out the new pension reform program Security Through Diversity. Security through Diversity was published in February 1997, three months after the shocking, sudden death of the Mr. Baczkowski. The proposal championed a multi-pillar pension system with a mandatory funded pillar, and with an innovative notional defined contributions pay-as-you-go pillar. The institutional changes, the financing, the transition, and the communication with the public were all worked out in great detail.

The program was supported by international experts, and wholeheartedly embraced by Baczkowski’s successors, first Jerzy Hausner and later Ewa Lewicka. The latter
It was the sincere conviction of plenipotentiary Ewa Lewicka and her two predecessors in the job that made the Polish pension reform possible. Today she is Deputy Minister of Labor with special responsibility for pensions.

After the implementation of the reform started in January 1999, two things became clear. First, that the Security through Diversity team was a great success, a victory pulled out against many odds. Second, that with the reform implementation, oversight of the system should be done by permanent institutions not the team of reformers.

The office of the Security through Diversity team was closed last summer. Rutkowski is now back in the World Bank’s headquarter in Washington DC, where he works on pension reforms in other countries as sector leader for social protection in Europe and Central Asia region. Marek Gora is teaching economics in Warsaw and actively advising on pension reform implementation in Poland and elsewhere. Ewa Lewicka is Deputy Minister of Labor with special responsibility for pensions. Jerzy Hausner teaches economics in Cracow. Ralph Harbison has just retired from the World Bank. What an extraordinary time that was! And how plainly it shows that the Bank can assist its clients in many other ways, than lending.

Rutkowski’s secondment ended in October 1997. Gora took over as director and led the team until the successful completion of the second part of the reform package in December 1998. The World Bank kept assisting the team through the Institutional Development Fund, and subsequently, through the PHRD grant to prepare the project, enhancing administration and management of the social insurance institution.

took over in October 1997 after the return to power of the Solidarity-based coalition. “The plenipotentiaries sincere conviction in pension reform and their professional and political efforts made it possible for reform to proceed,” says Rutkowski.

“We knew we could only make the reform if we worked with both the government, the opposition and the social partners, including unions and the private sector, and if we put a lot of emphasis on the communication with the public” says Michal Rutkowski. “It was necessary that a task force like ours was created. It could not have been done by the Ministry of Labor itself because they were overwhelmed by day-to-day responsibilities” he adds. The Security Through Diversity team was very different from the rest of the Ministry. They had a different style. “We worked hard, but we were also extremely enthusiastic and results-driven. We were a great team: collegial, informal, and highly motivated, so different from what is usually meant by bureaucracy” says Rutkowski with a grin.

Rutkowski’s secondment ended in October 1997. Gora took over as director and led the team until the successful completion of the second part of the reform package in December 1998. The World Bank kept assisting the team through the Institutional Development Fund, and subsequently, through the PHRD grant to prepare the project, enhancing administration and management of the social insurance institution.
Economy—overview: Poland today stands out as one of the most successful and open transition economies. Poland is the only country in Central and Eastern Europe which experienced fast GDP growth, and where the income per capita in 1999 was 20% higher than in 1989. In this period the government has also introduced a series of difficult social reforms in the areas of the pension system, health, education and decentralization. The privatization of small and medium state-owned companies and a liberal law on establishing new firms marked the rapid development of a private sector now responsible for 70% of economic activity. In contrast to the vibrant expansion of private non-farm activity, the large agriculture component remains handicapped by structural problems. The government’s determination to enter the EU as soon as possible affects all aspects of its economic policies. Improving Poland’s worsening current account deficit also is a priority. To date, the government has resisted pressure for protectionist solutions and continues to support regional free trade initiatives. The government’s export strategy emphasizes a more aggressive export assistance program. Warsaw continues to hold the budget deficit to less than 2% of GDP. Further progress on public finance depends mainly on comprehensive reform of the social welfare system and privatization of Poland’s remaining state sector. Restructuring and privatization of “sensitive sectors” (e.g., coal, steel, and telecommunications) has begun.

Facts About Poland

Population: 38.7 million
Life expectancy at birth:
- total population: 73.06 years
- male: 68.93 years
- female: 77.41 years (1999 est.)
Total fertility rate: 1.45 children born/woman (1999 est.)
GDP per capita: $3,900
GDP: $150.8 billion

Of the three pillars the first and the second are mandatory pillars with benefits closely linked to lifetime contributions made. The first pillar (5/8 of mandatory contribution) is predominantly notional defined contribution pay-as-you-go, although it has a small Demographic Reserve Fund in it, which is fully funded. The second pillar (3/8 of mandatory contribution) is a defined contribution fully funded pillar served by private pension funds. Both mandatory pillars are closely linked to each other: the same defined contribution principle, individual accounts, the same retirement age, benefits in a form of annuities, minimum pension guarantee based on both pillars’ accounts. All participants of the mandatory part of the system are subject to the same rules governing the contribution collection and benefit calculation. As opposed to this, the additional voluntary fully funded third pillar provides for significant differentiation in organizational principles and participation forms, which means that in the entire old-age pension system the magnitude of reallocation of income over life cycle can be adjusted to individual preferences.

Each of the pillars is exposed to different types of risk. The pay-as-you-go pillar is exposed to the risks of population-ageing, increasing unemployment and political pressures, whereas the funded pillars (second and third) perform better in the face of these risks, but are vulnerable to financial market downturns or prolonged inflation. The new Polish system diversifies risk.—“Security through Diversity” stands for risk diversification—each of the two parts of mandatory contribution work for future old-age benefit in a different way.

The new scheme is introduced gradually. Those born before 1949 stay in the old system (no choice of entering the new one); those born after 31 December 1948 are required to adopt the new system. Among them those born in 1949 through 1968 will have an option to choose either one or two pillar version of the new system (one or two individual accounts), while those born after 31 December 1968 will have to transfer 3/8 of mandatory retirement contributions to a chosen pension fund—which means splitting contributions between two individual accounts.

Beginning from 1st January 1999, the responsibility to generate funds for employee’s old-age rests jointly on an employer and the employee, which means the obligation to pay contributions is divided between them. Wages and salaries were grossed-up in order to avoid net change in anybody’s social security burden.

A ceiling on individual contribution base was introduced. People are mandated to participate in the pension system up to 30 times the monthly average wage per year. Above that ceiling income is contribution free.
“Security through Diversity” stands for risk **diversification**—each of the two parts of mandatory contribution work for future old-age benefit in a different way.
The first pillar, as it is the case in Sweden and Latvia, is based on a notional defined contribution principle, where the pension paid depend on: (1) the contributions made, index-linked to contribution base (wage sum), and (2) average life expectancy for men and women. Thus the later a person retires, the larger the annual pension paid. The fully funded Demographic Reserve Fund is to smooth first pillar revenues fluctuations.

The first pillar of the new system being based on individual accounts is not a continuation of the previous system. Everybody covered by the new system in spite of his or her age “retired” of the old system on 31st December 1998.—Pension rights earned under the previous system have been calculated as of the old system closing date (31st December 1998) and translated into zloty. Such “start-up capital” will appear on individual accounts (together with appropriate interest) by 2003.

The second pillar is served by open pension funds (joint stock companies) of employees’ choice. This second pillar started on 1st April, 1999 and those for whom splitting old-age contributions between the 1st and 2nd pillar accounts was compulsory—those born in 1969 and later—must have chosen a pension fund for their second pillar savings by the end of September 1999. Those born before 1969 had to make their decision before the end of December 1999. The decision to join the second pillar is irreversible. The transition cost of 2nd pillar implementation is covered by revenues from privatization.

The funds, in the second pillar are obliged to diversify their risk, and clear limits are set out as to where they can locate their investments—40% in quoted stock, 5% in foreign shares, 10% in the secondary stock market, 10% in National Investment Funds (NFi), 10% in National Bank paper and 15% in municipality bonds. Employees can only invest in one fund and, once the money is invested, it will be difficult to change to a new fund. Given this restriction, ensuring good access to information about the funds will be very important.

In a voluntary third pillar, contributions are paid into life assurance, pension and investment funds and employee funds. Companies are permitted to set up employee pension funds and mutual assurance funds on a voluntary basis. Contributions are paid from income after tax but benefits are tax free. There are, however, incentives in the third pillar to encourage employees and employers to set up group pension schemes.

Widespread occupational privileges in the Polish pension system have been eliminated for people covered by the new system. For some groups working in harmful conditions “bridging pensions” will be introduced as a way of financing the termination of work before the retirement age. Bridging pensions entitlements are linked to type of work conditions. A special Medical Commission prepared a list of such conditions (for instance under earth, under water).

One of the most important features of the new Polish old-age pension system is its separation from other elements of social security. There is no social security contribution in Poland any more. Instead of that, there are separate contributions financing each of social security elements. The most important is the separation of the old-age contribution (19.52 percent of the contribution base), that entirely goes into individual account, or accounts if the contribution is divided between the accounts-pillars. Other social security contributions such as disability, sickness, and so on, are kept outside the three pillar system that is solely an old-age pension scheme.

About the Authors
Marek Gora and Michal Rutkowski are “Security through Diversity” authors and reform team leaders. Gora is now teaching economics in Warsaw and advising on pension reforms issues. Rutkowski is leading the social protection group in the Europe and Central Asia region of the World Bank.
Good communication is crucial during a reform process. In Poland, the responsibility for the public relations (PR) campaign were put in the hands of professionals even before the reform had been written. After a tender, the job was given to Profile, a private communication firm centrally located in the capital city of Warsaw.

Michał Rutkowski and Marek Gora, who headed the pension reform team, gave high priority to a media strategy that meant that his team from the earliest stages would be open to talk to the media at any time in order to create an image of openness and being action oriented. “The reformers must always have something to say to the public, even before a clear message is fully developed and ready,” says Rutkowski.

In Profile’s high-tech offices, Rafal Szymczak, vice-president of and partner in the firm, sums up the recipe for the successful campaign. “Find out first what people think and then define your communication goals. Start working on the information campaign one to two years before the reform is implemented. And keep the reform process ‘above politics’ in order to create a broad support,” he says. Szymczak conducted the campaign together with his boss, President of Profile, Krzysztof Nowak.

Profile started preparing for the reform back in 1997 by first defining the goals of the campaign. Profile recognized that the PR campaign should support and reinforce the reform’s good image and build support among opinion leaders. Profile conducted research through a series of focus groups, which were socially and demographically representative. A survey of 1200 Poles was also conducted in order to understand the way the general public was thinking about the current system and what they felt would be the best system for the future. The answers showed that people attached a lot of importance to the link between contributions and benefits. This principle subsequently became a cornerstone of the reform.

Target groups
Then, Profile moved to provide the information necessary for people to make rational decisions and reduce the feeling of loss among the group of 50 years and older. In this phase, the company also defined its target groups of the campaign. On one hand, there were the opinion leaders including the media, trade unions, employers and decision-makers. On the other hand were the pension system participants that were divided into three groups. The first group was made up of people below 30 years of age with no options but to enter the new system. The second group constituted people of 30–50 years of age who had the choice of staying in the old system or entering the new one. The final group was made up of people above 50 of age who would automatically stay within the old system.

“From a reforming point of view, the positive message we got was that people found that the old system was bad, that the level of pensions were considered to be too low and that people had a belief in the capitalist system. The negative message was that the young people were not interested in thinking about their pensions. They were thinking only two to five years ahead and gave higher priority to their children and their cars. Nevertheless, they still wanted to have pensions that reflected their contributions,” says Szymczak.

A Clear Message
Based on the research, a strategy for defining the message, what instruments to use, and a time schedule was developed. And the reform process was given a visual identity with the logo and the name “Security Though Diversity,” selected by the reform team.

The message was clear—the old system was going bankrupt without reform and was giving the Polish society a bad image. The new system, on the other hand, was secure, fair, clear and immune to political manipulation. It was also made a point that pension reform was part of an international trend and that social security systems were being overhauled in many other countries.

During the first phase of implementing the PR campaign, the instruments used were direct communication using brochures written to target employers and trade unions. In addition, materials were prepared for policy makers. Finally, the media was given a vital role in supporting the positive image of the reform. “In Poland, the media has higher credibility than the government, so we needed the cooperation from them. Luckily, they were very positive towards the reform,” says Szymczak.
Working with the Media

The media was divided into three levels and the powerful cooperation with the press continued into the second phase, which started in 1999.

First, a group of 10–15 journalists who specialized in writing about the issues was designated “experts” and were kept informed at every step of the process—both on and off the record. “The goal was to keep these people well-informed and give them information even before it became public,” says Szymczak. “This group was also offered interviews when, for example, foreign experts visited Poland.”

The second level was the national media, television, radio, newspapers and weeklies. Written material was prepared for this group and it was invited to press conferences. “Journalists often change their jobs, so it was more difficult to establish close relationships with individuals. Instead we tried to establish a reputation for being reliable sources they could call anytime they had a question,” explains Szymczak.

The third level was the regional media. Szymczak believes that this is a very important group. In Poland, 70 percent of the newspapers are regional so they have a big impact on public opinion. The problem for the regional media is accessing information in Warsaw. Consequently, Warsaw brought the information to the regions. A series of eight seminars in eight Polish cities were prepared for regional journalists. The seminars would last three to four hours and experts from the Security Through Diversity Team and Profile made presentations. These presentations reinforced the image that the authors of the reform were not politicians but experts who were “above politics.” “This was easy because demand for reform was as high among the left as the right and among people in general,” adds Szymczak.

In addition to the campaign conducted by Profile, groups of important opinion leaders were invited on study tours of countries that had already reformed their pensions system. These trips were financed by a group of foreign donors. Over 10–14 days, the groups were introduced to economists, trade union leaders, media, pension fund presidents and supervision institutions in order to get a first hand impression of a pension reform.

The Second Phase

The second phase of the PR campaign targeted a broader audience. “At this point we faced two problems. Our budget was unclear and we were facing the difficult communication problem of having to send out mixed messages. Among the different age groups, what was good for one group, might not be good for the others,” says Szymczak.

At this point, the government was also no longer alone in the communication market. Twenty-one private pension funds were starting their own campaigns to gain as many clients as possible for their respective funds. While the government conducted an information and educational campaign, the private sector advertised on image and emotions. “We had to make it clear that the new system would not be good for everybody between 30 and 50. From calculations made by Agnieszka Chlon from the reform team, we knew that for many over 45 it would be better to stay in the old system,” says Szymczak.

Good media relations helped this message to get through—most newspapers produced a special section about pensions at some point during 1999. The credibility of the press and the interest in the issue was reflected in the fact that circulation could increase up to 20 percent on these days. To further help increase the rational basis of decisions of persons in the 30–50 age group, computer simulation software was made available on the Internet. This made it possible for an individual to project his or hers different options and see which one was the most beneficial. Information centers were another important information tool in the campaign. At these centers, people could call with questions and get brochures. In order to meet the information needs of specific groups, close to 20 different leaflets were produced. The centers were advertised in the media and received 150,000 calls. This was less than expected. Szymczak gives two explanations. First, the Poles were not familiar with using the telephone in this way. Second, it was not free to call the centers. People could, however, call from work in order to avoid being charged for the call.

The Polish government spent approximately $4 million on the PR campaign. The funding came from a consortium made up different donors including USAID and the Swedish government.

The well-planned PR campaign has paid off. Media coverage has been overwhelmingly positive and helped the 30–50 year olds make the right decision for themselves according to Profile’s research. In addition, the evaluation of the reform shows that of the 50+ age group, which is normally the one who fears pension reform the most, only nine percent think it is a bad reform. ▲
Polish women are at risk of losing out on the pension reform’s potential rewards.
A last minute decision by the Polish Parliament to leave women’s retirement age at 60, five years lower than that of men, puts women at risk of becoming losers of the pension reform, according to Aleksandra Wiktorow. She was a member of the team of economists behind the country’s new pension system. Today she is vice-director of the Gdansk Institute for Market Economics in Warsaw and professor at the University of Insurance and Banking, conducting research on the social and legal consequences of the pension reform.

The political decision was made because many Polish women are reluctant to give up their traditional role in the family, which include early retirement, according to polls. “The problem is that Polish women do not look at what will happen over the next 30 years,” says Aleksandra Wiktorow. “The Polish women tend to look at these matters from the standpoint of their mothers and grandmothers and want to retire early. But they do not realize what consequences this attitude will have on their pension,” she adds.

“There is a huge discussion about whether the retirement ages should be the same for men and women, and whether women should be given the option to continue working,” she informs. “In theory they can continue to work, but in fact they do not. Most want to retire early, the rest is often laid off when they hit retirement age. Many court cases show that women are being made redundant exclusively on the basis of reaching the retirement age—and the courts uphold the decisions in almost every case.”

In the new system pensions are strictly proportional to the accumulated capital of the individual, and the widespread early retirement privileges inherited from the Communist era have been abolished, effectively increasing the retirement age for women from 54 to 60 and for men from 59 to 60. “The five years gap between when men and women retire has a huge impact because it translates into very big differences between the actual pensions received,” explains Wiktorow.
When Poland’s pension reform came into force in January 1999, it was also the starting signal for 21 newly founded private pension funds. The private sector lobbied efficiently as an entity to support the reform. Today the same businessmen are in a fierce competition for survival, according to Krzysztof Lutostanski, President of PKO/Handlowy pension fund and President of Poland’s Pension Funds Chamber. The funds will accumulate huge private savings that are much needed for long-term investments in the Polish economy.

Lutostanski have confidence that it will be the big well-known companies that will end up as the winners. Already the three largest companies—Commercial Union, PZU, and Nationale Netherlanden—serve more than 50 percent of the more than nine million clients that has already signed up. “People go to well-known companies. They prefer the pension funds established by the big insurance companies where they are already customers and feel comfortable,” says Lutostanski, whose own fund is created by two major banks.

He estimates that the total cost of establishing the pension market was roughly $600 million. It has been a speedy process. The law on private pension funds was passed in August 1997. The first applications for licenses to establish private pension funds were submitted in August 1998, and the first licenses were granted in November, just four months later. As mentioned, 21 new funds went into business on January 1, 1999.

“From a technical point of view, it was not easy to implement the needed information technology in such a short period,” says Lutostanski, “but we did it. Unfortunately, we cannot observe the good results because of the problems on the government’s side.”

One significant setback has been the social security institution’s (ZUS) handling of the technical side of the implementation. ZUS was assigned to collect and distribute pension savings, but it was not up to speed and failed to install the necessary computer systems on time. Some chaos ensued. Pension funds have been receiving just a fraction of their money and the collected pension savings have been diverted to pay the governments current pension expenses.

Nonetheless, nearly everyone agrees that these problems are “childhood diseases” that will be outgrown soon as ZUS is now under new leadership. It is still too early to see how successful the funds are. A good indication that they are on the right track is, however, the fact that the nine million clients signed up with the funds exceeds expectations by a third. The funds’ investments are showing successful with strongly positive rates of returns.

Lutostanski expect the first funds to be able to produce the their first profits in a couple of years.
Nonetheless, so far a majority of Poles say they are happy with the new system, especially being able to see their pensions relate directly to their incomes over their working careers.

They are also pleased with the added guarantee of a minimum pension. After the excessive redistribution that Poles experienced under Communism, Poles prefer to take care of themselves, not everybody else.

**Unrealistic Expectations**

Aleksandra Wiktorow is, however, convinced that this enthusiasm is based on unrealistic expectations on behalf of many Poles. “There will certainly be a lot of people who will not have been able to save enough to rise above the threshold of the lowest possible pension. Many people do not realize this at the moment,” says Wiktorow. Even though she is fully convinced that that the new pension system is good for her country overall, she believes that room should have been made for redistribution of the system.

In addition to the minimum pension, another redistribution element is that the state is paying a premium based on the minimum salary while women are on maternal leave and to some people on social assistance.

“This benefit is, however, not enough to prevent women from losing out in this reform,” says Wiktorow. “It is much less than the income most of them would have made if they could stay in the labor market instead of taking maternal leave. But many women cannot even go to work while their kids are small because of the ruling coalition’s family policy of keeping women at home. That means, for instance, that the number of day care centers is decreasing,” she says. Wiktorow believes that when enough women realize how their lower retirement age disadvantages them, they will demand they demand the right to retire at the same age as men.
Of the world’s six billion people, less than a third of the workforce is covered under a formal pension scheme. Robert Holzmann wants the world to do better.

“In many poor countries, the formal pension systems are a drain on the poor,” explains Robert Holzmann, Director of Social Protection Sector of the World Bank, when asked why the Bank is getting increasingly involved in pension reform. “Not only do these systems essentially cover the middle and upper classes that are already well off. They are also often running large deficits and requiring budgetary transfers that are imposing taxes on the poor and consuming resources that could be used for education, health and infrastructure. In short, the systems are a barrier to economic development.”

Over the last decade, helping countries develop sustainable and socially fair pension policies has become a new but important way for the Bank to meet its mandate: to help countries grow economically, and, in doing so, reduce poverty.

The World Bank’s vision

“The World Bank’s vision on pension reform is often misunderstood,” Holzmann says. “Our goal is not to sell the Chilean pension system world-wide. It is important for me to make clear that the Bank wants to help low and middle income countries create retirement income systems that include as many as people possible—not just those who are already well off—in a way which is socially equitable, financially and politically sustainable, and furthers economic development,” Holzmann explains. “We also want to prevent workers and the self-employed in the informal sector, who are currently above the poverty line, from falling into poverty once they get old. And equally important, our aim is to prevent the lifetime poor from falling into complete misery once they become old and unable to provide for their own.”

Holzmann, a native of Austria, has been with the Bank since the Social Protection Sector was formally established in 1996. He is on leave from his position as Professor of Economics and Director of European Economy at University of Saarland, Germany. He received his Ph.D. in economics from the University of Vienna.

Holzmann has been a leading force in the Bank’s increasing focus on pensions—an area which began to attract the financial institution’s serious attention in the late 1980s.

The initial interest stemmed from the Bank’s work with Latin American countries that had begun to question social policies that often promised a great deal, but delivered little. Then came the regime change in Central and Eastern Europe and the former Soviet Union, when the Bank became deeply involved with countries that were burdened with dysfunctional pension systems typically made worse by economic transition. With the unfolding financial and social crisis in East Asia, the Bank started to assist these countries in moving toward financially sustainable schemes for large segments of society.

Startling statistics

Holzmann likes to emphasize that of the world’s six billion people, less than a third of the workforce is covered under a formal pension scheme. In fact, evidence suggests that while many countries have begun or are contemplating a move toward a multi-pillar pension schemes, coverage may actually be declining. “We want the world to do better than that,” says Holzmann.

The problem is not that the reforms are flawed, but that they have not gone far enough, according to Holzmann. His goal is to find out which system design can best achieve coverage not only of the formal sector, but the informal economy as well.

“Our studies show that the working poor and self-employed continue to have a specific and strong rationale for avoiding participation in formal multi-pillar pension systems,” Holzmann says. “Joining the official system is too costly for them.”
The culprits

There are several culprits. In many developing countries, a large segment of the population may be too poor to participate in a contributory system. “Income security in old age is simply not a primary concern for these people,” Holzmann explains. “Poorer people would rather consume income today than save to consume in the future, when, because of their relatively higher mortality, they may not be around.” In addition, the self-employed, particularly the poorest, may find it optimal to avoid pension systems, because these may make it impossible for them to invest in their own business. Simple shortsightedness may also play a role, as people fail to recognize a benefit long delayed into the future. As a consequence, many poor households will have to rely on publicly provided social assistance, where it exists, continued work or family and community support.

Other barriers to poor people’s entrance into formal pension systems include structural factors and lack of credibility. “Households may put little stock in the promises of government,” Holzmann says. “And reformed pension systems may suffer from an inherited lack of credibility of formal pension institutions. On the other hand, workers may also be uncomfortable with the ‘privatization’ of social security and have little faith in the profit motives of the private sector.”

Another deep concern is the high transaction costs the poor face, not only in pension systems, but in financial transactions generally. “Since these people are mainly out in the rural areas, outlets to collect or lend money do not exist, and if they do, they are very expensive,” Holzmann says. “If we do not provide these currently non-poor with appropriate savings vehicles, they will become poor in their old age. This is a huge worldwide problem we are facing. These people need low transactions costs and instruments to transfer financial resources from now to a distant future, when they are going to need it.”

But at the same time, he adds, “We must also make sure that they can get access to this money in times when it is needed, as when a cyclone hits again or someone wants to buy land or inputs—and they do not have sufficient cash for investment,” says Holzmann.

A first step

“We know that financial institutions are something that comes with economic development. A good first step in this direction might be to further develop micro-finance institutions, which often work within communities and know their customers personally—and thus have other means of interaction,” he says. These can minimize costs, partly because they do not place their highest priority on profit maximization. “There are many good examples throughout the world that show how such an approach can both encourage the poor to save and provide them access to credit when they need it,” Holzmann says. Two prominent examples are Bank Rakyat Indonesia-UNIT DESA and Banco Sol in Bolivia, both set up with the sole aim to help the poor both save and obtain credit.

“We need a better understanding of the constraints to broader coverage under formal, contributory pension systems,” says Holzmann. “And we will develop that. But we must also make sure that the lifetime poor and informal sector workers receive coverage under non-contributory schemes or have access to retirement savings instruments.”

Photos: World Bank
The Secrets of Pension Reforms On-line
The World Bank Launches New Pension Primer on the Internet

What are the options to reform a pension system? How do you finance the transition from pay-as-you-go pension systems to multi-pillar pension systems? How do you design a market and regulatory structure for the pension system? What is the latest evidence on the link between pension systems, labor markets, capital-market development, domestic savings and economic growth? What are the rules and international practice of taxing pensions? What are the key elements and lessons from pension reforms in Bolivia, Poland or the UK? These and other key questions are the subject of the Pension Reform Primer which will be officially launched on March 1, 2000.

The World Bank’s new Pension Reform Primer is a comprehensive, up-to-date resource that can provide the policy makers and those who advise them with the tools needed to answer many of the important questions a reform process arises. The Primer is the product of the World Bank’s growing team of pension economists and is managed by the Bank’s Social Protection Sector (SP). Experts from around the world contribute and review its content. The Primer is available on the Internet as well as in hard copy from the Social Protection Advisory Service.

The Pension Reform Primer is the brainchild of Robert Holzmann, Director of The World Bank’s Social Protection Sector and chairman of the Primer’s Steering Committee. The Primer is managed and edited by Robert Palacios, World Bank Economist and Edward Whitehouse, Economist and Director of Axia Economics, London. Palacios is a pension specialist, who was on the team writing Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth, the World Bank study published in 1994 that helped shape the global debate about pension systems. Whitehouse is a former social affairs correspondent for the Financial Times who worked extensively on pension and other issues at the OECD and the Institute for Fiscal Studies in London. Both editors have hands-on experience with pension reforms in several countries.

“The primer is a dynamic product. We will keep adding new papers and updating our Notes series, so that it will reflect what is currently going on in the world. The material will gather lessons and experience of pension reforms around the world,” says Palacios.

Building on the pioneering work and the practical experience of the World Bank over the last decade, the material covers country and regional experiences as well as specific reform topics. The Primer papers provide the in depth examination of issues concerning implementation of reform, design, administration, and regulation along with the country and regional studies. The Primer Notes provide concise and up to date information. The 3-4000 word Notes attempt to summarize better practices for reform topics and are constantly updated to reflect the latest literature and empirical evidence.

The Pension Reform Primer is available on-line at www.worldbank.org/pensions.

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New software from the World Bank makes reforming easy and accurate

Pension reforms are now at the policymakers' fingertips. After much testing, the World Bank's innovative software PROST (Pension Reform Options Simulation Toolkit) is now available for reforming countries who want to project the behavior of their existing pension system and test the impact of different reform options. Furthermore, they can also use PROST to calculate implicit pension debt, financing gaps, individual accounts and simulate systemic transitions.

PROST has been developed by a World Bank team under the leadership of Anita M. Schwartz, Senior Human Resources Economist of the Bank's Social Protection Sector.

“In 1994-1996, a colleague of mine and I were constantly being requested to evaluate the pension reform proposals in country X and to verify simulations done in country Y. With only two of us in the unit, the job was overwhelming. We also noticed that a lot of the methodology we were using in our evaluation process from country to country was similar. So we decided to develop a model, which was generic enough to be used for many countries, but very user-friendly, very flexible, and very fast,” explains Schwarz about how the idea of PROST was born.

PROST serves several objectives: government officials can use the model to do their own simulations; policymakers can test uncomplicated cases with the model to simply learn how pension systems operate; country economists within the Bank can use the model with little input from the pension team and the pension team can use the model to verify work done by others.

The first PROST model became available in July 1997 and has undergone enormous changes and improvements since then with each new version thoroughly tested to determine that the calculations are accurate.

“One of the many advantages of PROST is that it has saved the Bank's client countries the hundreds of thousands of dollars they were spending on models built by consultants which then proved to be inaccurate,” says Schwarz.

Among other main positive results she mentions the enormous capacity PROST provides to policymakers.

“Prior to PROST, most policymakers had to hire specialists who took six months or more and might provide limited output for one or two scenarios. If Congress changed one parameter in a reform proposal or a policy maker wanted to see what happened if output growth was lower, it became a huge undertaking,” says Schwarz.

Another pre-PROST problem many policy makers around the world faced was that many of the assumptions on which a reform model were built were not visible.

“Inputs went into a big black box and output numbers came out, but where they came from was a mystery,” says Schwarz.

Now policymakers can do the simulations within his/her own team. With PROST it takes only a minute to run different reform proposals and scenarios. The assumptions are all perfectly transparent and there is a formula manual, which explains how each number, is calculated.
“Enough output data is produced that you can even hand calculate a couple of numbers to verify the calculation accuracy. This has given enormous capability to the policymaker who can now tell the difference between reform options and have the projections output to explain, why one is better than another or under what circumstances one is better than the other,” says Schwarz.

The countries that to date have used or are using the model include Brazil, Uruguay, Ecuador, Guatemala, Nicaragua, Kazakhstan, Kyrgyz Republic, Thailand, China, Korea, Philippines, Sri Lanka, Indonesia, Namibia and Zambia. The European Central Bank has reviewed the model and its staff has received training so that the model now also covers the current EU countries and many soon to be members.

The World Bank offers a series of training courses in how to use PROST, from a one-day introductory course to two full weeks of intensive training.

Upon completion of the training session, individuals will receive a copy of PROST and sign a licensing agreement which will authorize its use in specific countries only, any use beyond the authorization will require a written permission from the World Bank. Then the individual to whom the model is transferred must sign a separate licensing agreement with the Bank.

The countries that to date have used or are using the model include Brazil, Uruguay, Ecuador, Guatemala, Nicaragua, Kazakhstan, Kyrgyz Republic, Thailand, China, Korea, Philippines, Sri Lanka, Indonesia, Namibia and Zambia.

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### Percentage of Population over 60 years old—Averages by Region

<table>
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<th>Region</th>
<th>2000</th>
<th>2010</th>
<th>2020</th>
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<td>Eastern Europe &amp; Former Soviet Union</td>
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<tr>
<td>High-income OECD</td>
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**Source:** SIMA statistics
October 1994 marked the launching of *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth*, the World Bank study that helped shape the global debate about pension systems. It culminated more than two years of work by a dedicated team. Averting took a sweeping global view of social security systems, focusing on their impact on the broader economy as well as their impact on the old. Social security taxes and transfers create incentives that influence peoples’ behavior—their willingness to work, save and employ other workers. Therefore, the choice of system helps determine the size of the GNP pie that is available for everyone, both old and young, to consume. Then, policies should be chosen that give us the biggest pie and the best distribution. This was the central message of Averting. It was this line of reasoning—the emphasis on efficiency and growth effects, as well as the importance of distribution and transparency—that led us to recommend structural reform, the shift to a multi-pillar system in which part of peoples’ mandatory retirement income would come from their own savings (Pillar Two) and part from a social safety net that was run by the government (Pillar One).

Pillar One recognized that the government had an obligation to keep people out of poverty, including those whose lifetime earnings were too low to support them in old age. Pillar Two was designed to address worker myopia and moral hazard and ensure that workers with above-average earnings saved enough while young to continue an adequate standard of living while old. Personal saving or saving through a company plan seemed like a less distorting way of accomplishing this than a tax and transfer system embedded in PAYG methods. It also created the potential for increasing long term saving and therefore the productive capacity of the economy. This would enable countries to support consumption by the increasing proportion of elderly, without decreasing the standard of living of the young. Funneling these savings through defined contribution plans creates the right incentives to seek high risk-adjusted returns, without distorting labor incentives. We recommended private management of the funds because empirical data indicated that public management facilitated political manipulation of investments that led to low, even negative, real returns for the pension scheme and the economy.

During the past five years I have often speculated on why Averting created such a furor, when it was first released. First, it took a strong stand on some issues, such as the importance of pre-funding part of the social security system, with private management of the funds. Second, it contested the “conventional wisdom” and claimed that the system that many analysts had supported was basically flawed—in terms of its impact on growth but even more so, its impact on income distribution. In examining the empirical evidence we found that traditional social security systems did not redistribute to the poor but often, perversely, to the rich, and mainly to the first generations to be covered. This happened, not because of a conscious collective choice, but automatically, because of the way PAYG systems work and because the redistributive effects of the defined benefit formula were difficult to measure, hence illusions could easily be created. Supporters of single-pillar PAYG systems were defensive about these critical findings.

1 Besides myself as team leader, the team consisted of: Dimitri Vittas, Robert Palacios, Anita Schwarz, Klaus Schmidt-Hebbel, Asli Demirguc-Kunt and Louise Fox.
Averting was destined to have a substantial impact on the debate and on policy outcomes because it came along at the right time, as populations were aging, pension systems were in trouble and growth had slowed down in many countries…

Unfortunately, the attacks on Averting were often based on a misreading of the report. For example, we were accused of:

Ignoring distributional considerations— but one of the major reasons for the recommended multi-pillar system was to achieve a more equitable income redistribution, via a transparent first pillar and the avoidance of automatic inter-generational transfers;

Recommending a risky system— but a major raison d’être for a multi-pillar system is diversification of income sources, to reduce risk;

Advocating a one-size-fits-all policy— but we stressed that the first pillar could take a number of alternative forms as could the second pillar, and that the mix of sizes between the two pillars could have a wide variance. Indeed, nineteen countries have already adopted the multi-pillar system that Averting recommended, and nearly every one of them did it differently. Chile, El Salvador and Kazakhstan used a minimum pension guarantee while in Mexico this guarantee is buttressed by a one peso per day government contribution to each worker’s account. Various combinations of flat or means-tested benefits, sometimes financed by general revenues and sometimes by earmarked contributions, are found in the UK, Denmark, the Netherlands, Argentina, Australia, and Hong Kong. In Switzerland a compressed earnings-related defined benefit comprises the first pillar, while in Uruguay and Hungary the first pillar is much larger and more positively related to earnings. Poland and Sweden use a large notional defined contribution plan for their first pillar. And the second pillar is based on individual choice in Latin America, Hungary and Poland, occupational choice in Switzerland, Australia, Denmark, and Hong Kong, a combination of the two in the UK and competitive bidding in Bolivia. In Chile and Peru contribution collection and record-keeping are decentralized, while in Argentina and Sweden it is centralized.
And so on. The ability of the human mind to devise variations on a theme never ceases to amaze me. Yet, all these schemes have in common an institutional arrangement to prevent old age poverty plus a separate funded arrangement for retirement saving, with the funds decentrally managed.

Averting was destined to have a substantial impact on the debate and on policy outcomes because it came along at the right time, as populations were aging, pension systems were in trouble and growth had slowed down in many countries—so they realized they had to stimulate their economies while caring for an increasingly older population. Altering their systems to make them more pro-growth and to eliminate redistributions that were neither efficient nor equitable seemed like a logical move. Averting provided an analysis, rationale and very generalized blueprint of how this could be done. This intellectual justification helped to spread multi-pillar systems to many countries in the developing and transitional worlds.

Additionally, several members of the Averting team moved into operations after the report was written, and actively implemented its ideas. As principal author I and other team members embarked on an enthusiastic dissemination campaign, perhaps more active than that associated with most Bank research activities. It is interesting to note that general thinking in this area has shifted over the past five years so that many of our ideas that were initially controversial—the importance of pre-funding (to desensitize old age systems to demographic change and increase long term saving) and the need to insulate the funds from political manipulation—have become almost mainstream now.

This leads me to my final point—we are all indebted to the Bank’s research management which gave us ample time and freedom to analyze the situation as we saw it and to disseminate the results of that analysis. This was not a bureaucratic management pushing an ideological line or trying to avoid dissent. Rather, it was a management that respected the research process and the active interchange of ideas. Here I am referring to the Chief Economist and Research Directors during and immediately after the period when Averting was written—Michael Bruno, Nancy Birdsall and Lyn Squire. We owe them a vote of thanks for their “hands-off” policies and moral support that made this work possible.
But necessity is the mother of invention—or in the case of pensions—the mother of radical new thinking. Around the globe, the textbooks on pension policy are being rewritten, as developed and developing countries alike have discovered that their traditional pension systems can no longer deliver what was promised. As efforts to reform traditional unfunded pension systems have failed time and again, policymakers around the world increasingly have come to the conclusion that shifting away from centralized, unfunded pension schemes toward decentralized, funded pensions is not only more fiscally sustainable, but can enhance economic growth.

Brazil is a good example of what decision makers are up against. The Brazilian economy collapsed in 1998 under the unsustainable weight of a public spending deficit that reached eight percent of GDP—of which three quarters was contributed by an overly expensive pension system that only threatened to become an even heavier economic burden in the future.

The numbers show that many countries are heading for the same kind of trouble: ever-growing pension costs for the elderly to be paid by a shrinking number of younger workers, unless action is taken. Over the next five decades the share of the population over age 60 in OECD countries and in transition economies is going to rise by more than more than half, according to World Bank studies. In the OECD, the over-60 population will rise from 20 percent to 31 percent. In transition economies, nearly 27 percent of the population will be over 60, compared to 17 percent today. All other regions in the world are following this trend with a time lag.

The multi-pillar system
Over the last decade, the World Bank has become an advocate of the so-called multi-pillar system because it reduces the risk of future financial collapse by diversifying future pension benefits into three pillars. The first, public pillar, is a publicly managed, defined benefit scheme funded by payroll taxes or general revenues. It focuses on redistribution. The second pillar is a mandatory but fully-funded and privately managed scheme. It demands individuals to save for their own old age, but generally does not redistribute wealth. A third pillar consists of voluntary savings; in order for individuals to accumulate these savings, the mandatory pensions must be small enough to allow people to choose how to allocate their income over their lifetimes.

A global leader
Bank staff has been or is currently engaged in pension reform design and implementation in more than 35 countries. Today the World Bank is a global leader in this area, providing adjustment lending, project lending and technical assistance.

Experience shows that to be successful, pension reform must reflect a country’s preferences. If it does not, even the best technically prepared pension reform is likely to fail. Sound reform criteria are equally essential, as well as meeting distributive concerns. These include, among other things, an assessment of the benefit level for pensioners who continue under the old scheme, the prospective benefit level for workers entering under the new scheme, the availability of periodic payments and the provision of disability and survivors pensions.

It is equally important that the macroeconomic and fiscal policies of a reforming country are sound over the long term and that the administrative structure is capable of operating the new pension system. Finally, the country must have appropriate regulatory and supervisory arrangements and institutions in place.

Pension reforms are about securing pension for the future generations in their old age.
There are basically three types of pension systems. The first is the large, old-style public ‘solidarity system,’ in which the government guarantees the level of benefits. This is known as a defined-benefit system. Such systems are typically unfunded; expenditures on benefits are “paid as you go,” hence the term “PAYGO-system.” A second type is a funded system, where individuals’ mandatory contributions are saved and invested to pay their future pensions and where benefits depend on the assets in the account at retirement, so-called defined-contribution systems. Finally, there is a hybrid of these, the above mentioned multi-pillar system.

The PAYGO system
In principle, a country with a PAYGO system can address many of its reform needs without moving to a funded system or a multi-pillar system, but simply by reforming the PAYGO-system itself, i.e. changing the retirement age, adjusting benefits or increasing contribution rates. But such a parametric PAYGO reform is often unattractive to politicians, because the fiscal and economic gains of the reforms would be harvested after they leave office, while the political costs—such as the higher retirement age or lower benefits—would be imposed immediately. On the other hand, undertaking continuous marginal changes is also not ideal either, because they create a time consistency problem.

A more promising strategy for PAYGO reform is, perhaps, to move toward a Notional Defined Contributions (NDC) system. The NDC approach uses the vocabulary of funded individual accounts to define PAYGO promises. Thus, there is a direct link between the pension the individual will receive and his or her contributions. This extra transparency helps both policymakers and the public to understand better the trade-off inherent in any PAYGO arrangement. NDCs have already been introduced in Sweden, Italy, Latvia and Poland, and there are various other countries studying this approach. While the benefit formula takes care of increases in life expectancy, the challenge with this approach is to make sure that that sufficient financial reserves are accumulated to cope with future demographic changes.

The fully funded scheme
A shift towards a fully funded scheme addresses, in principle, all the incentives and most distribution issues, as well as the issues of savings, intergenerational equity and capital market formation that a PAYGO-reform, including the NDC, fails to achieve. But this approach poses three other problems. First, there is the problem of the commitment not only to current retirees, but also to current workers who have acquired rights under the PAYGO regime. That means that the younger generations will have to both fund current benefits through their taxes...
and save for their own future pensions. This is the so-called transition problem. Secondly, there is the question whether a country’s infrastructure, regulatory capacity, and political economy are equal to the task. Third, risks of financial market fluctuation must be adequately addressed. All three issues are also present under a multi-pillar reform, but here they are diminished and more manageable.

**Advantages of the Multi-Pillar System**

Multi-pillar systems already exist in many advanced countries such as Australia, Denmark, the Netherlands, Switzerland, and the U.K., and most of the recent reforms in Latin America and Eastern Europe are based in this approach.

The multi-pillar model has several advantages. It allows a distinction to be drawn between poverty reduction and income replacement goals, and it builds risk diversification into a country’s provisions for retirement income support. In addition, it minimizes the burden of fiscal transition while preserving many of the economic gains of the fully funded approach. Finally, it brings some clear gains for younger workers.

**Knowledge-sharing**

As the World Bank becomes increasingly involved in pension reforms in all regions of the world, the lessons learned provide a unique set of information that can be productively applied to other reforms. The World Bank is sharing its knowledge through various new projects besides the traditional working papers and Conference and Workshop Proceedings. These new initiatives currently include a “Primer on Pension reform,” a public Internet site and regional hubs on reform lessons.

When the Bank gets involved in providing technical assistance to a reform process the objective is not only to offer advice but to strengthen local reform capability and ownership in the reform. Once the seeds are sown, the Bank can take the next step and provide training for the technicians who will administer the future public and private pension related institutions, making sure the country has the needed capacity in administration, regulation, and supervision. These activities, headed by the World Bank Institute, include:

- An annual workshop together with the Harvard Institute for International Development.
- A Core Course on Pensions, targeting technical staff from the World Bank’s client countries.
- Regional workshops and conferences.
- A Flagship Course in Pension Reform by the World Bank Institute

Over the next five decades, the over-60 population in OECD countries will rise from 20 percent to 31 percent. Nearly 27 percent of the population in transition economies will be over 60, compared to 17 percent today. All other regions in the world are following the same trend with a time lag.
The Bank is also addressing one of the biggest challenges of pension reform by creating awareness of the issues among politicians and the populations at large. It is almost an iron rule that only when politicians and the public are informed about the medium and long-term financial unsustainability of the current pension scheme, that a more-than-marginal reform approach can be launched. For this purpose the World Bank has developed PROST (Pension Reform Options Simulation Toolkit). Once filled with country-specific data and system information, PROST can provide long-term projections of the current scheme and main alternatives.

**International Partners**

The World Bank’s approach is also characterized by an out-reach to old and new international partners such as the International Labor Organization (ILO), the OECD and the regional development banks in order to strengthen the reform message and to overcome the sharply conflicting views that in the past have too often confronted countries seeking advice on reform. Needless to say, the Bank has with regard to reform design and implementation intensive contacts with its sister institution, the International Monetary Fund (IMF). In the past, the fiscal stance of the IMF and the way general government deficits are defined have hampered the move towards funded pensions. The IMF has recognized, however, that reform-induced deficits do not necessarily reflect an irresponsibly expansionary fiscal policy, but should rather be viewed as a healthy investment in a sustainable pension system that will pay itself off in the long run.

The World Bank is behind cutting-edge research when it comes to pension reforms but is beginning to feel confident that it has found the recipe for a successful reform. The ingredients are the ones mentioned above: flexibility, ownership, credibility, sound reform criteria, knowledge transfer and capacity building. Experience shows that countries that discard these components are most likely to end up making future generations pay a very high price in social, economic and political terms.

**Experience**

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*Photo: World Bank*
“Project Culture”

First I want to congratulate you with the first copy of SPectrum. It is impressive reading, design and lay-out. I welcome the idea of letting SPectrum “become a global forum in which ideas, knowledge, and opinions covering the full spectrum can be exchanged.” In my opinion such a forum is needed.

My reading about the Lithuanian Social Policy and Community Social Services Development project caught my interest but also raised some annoyance.

During 1998/1999 The Danish Ministry of Social Affairs financed two projects in Lithuania where I was employed as a consultant: “Development and Establishment of Home Care Services in Lithuania” and “Improving Effective Work in Social Care Institutions.” For both projects the task was to set up a Policy Paper for the future development and change, to describe standards and norms, to train staff members to their future jobs and to train future trainers. Now reading SPectrum, I see that we have worked on parallel lines. The ideas behind the Danish projects were also to break down the large residential institutions into small units in close contact with the local community and to prevent the need of residential care by offering community social services. Therefor my annoyance.

It is my impression that the many simultaneous international projects easily have the consequence that no one have a general view making it possible to coordinate the efforts even if the will should be present. We see a number of separate initiatives instead of a coordinated strategy. In that way so much of efforts and investments easily come to nothing or less than possible.

For me it is the occasion on in general to question mark what I will call the obvious present “Project Culture.” Maybe we are too eager about offering our money and assistance without first making sure that the motivation and readiness for the project are present at the recipient. Money easily becomes more tempting for the beneficiary than the objective of the project.

What “Project Culture” should stand for in my opinion is a common attitude of open and respectful cooperation between motivated and reliable partners. The World Bank with its obvious authority can no doubt contribute to prepare the way for this.

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The World Bank study “Averting The Old Age Crisis” is for sale at

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Flagship Course in Pension Reform
Many policy-makers are grappling with the difficult questions of how to reform their pension systems. Now help is on its way. A new two-week flagship course of pension reforms offered by the World Bank Institute has been designed to help Bank staff and their country counterparts tackle these challenges. The course will feature presentations by leading scholars in the field, both from within and outside the Bank, and by policymakers who have successfully designed and implemented pension reforms in their own countries.

Participants will also get to work with a simplified version of the World Bank’s pension simulation model, PROST. The first course will take place in Washington D.C. March 6–17, 2000. WBI plans to follow up with new courses later in the year. The course director is Estelle James, Lead Economist and principal author of Averting The Old Age Crisis.

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