European University Institute

Department of Political and Social Sciences

Pension Reforms in Central, Eastern and Southeastern Europe: Legislation, Implementation and Sustainability

Igor Guardiancich

Thesis submitted for assessment with a view to obtaining the degree of
Doctor of Political and Social Sciences of the European University Institute

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No PhD dissertation is a truly individual endeavour and this one is no exception to the rule. Rather it is a collective effort that I managed with the help of a number of people, mostly connected with the EUI community, to whom I owe a huge debt of gratitude.

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Abstract

This dissertation traces and analyses the legislation and implementation of pension reforms in four Central, Eastern and Southeastern European countries: Croatia, Hungary, Poland and Slovenia. By comparing the political economy of their policymaking processes, the thesis seeks to pinpoint regularities between institutional settings, actor constellations, decision-making strategies and reform outcomes. The study allows us to address three research questions: Why was reform possible and how was it carried through? What are its distributive consequences? Does it guarantee long-term political support?

The main argument of this research is that viable pension reforms should not be seen simply as an event, but rather as a continuing process that must at all times be fiscally, socially and politically sustainable. In particular, the primary goal of a pension scheme is to reduce poverty, provide adequate retirement income and insure against the risks of old age within given fiscal constraints, and this will happen only if the scheme enjoys continuing political support at all levels. Elaborating on this premise, the research makes four broad claims; two related to the legislative phase and two to the implementation of reforms.

First, I argue that the fiscal unsustainability of post-socialist pension systems, as well as their abuse in providing a *de facto* safety net for redundant workers, quickly exhausted the possibility of enacting simple corrective measures (via refinancing and retrenchment). This forced policymakers to engage in negotiated bargains with the pro-welfare coalition. Complex political exchanges became central to the restructuring of public schemes and a fundamental ingredient of successful reform.

Second, I claim that systemic reforms that seek to introduce policy innovations, such as funded elements, into a Pay-As-You-Go system, can be politically superior to more traditional parametric changes. Systemic innovations can be a substantial source of credit and popular support for policymakers. This provides them with greater room for manoeuvre vis-à-vis the pro-welfare coalition, which typically supports the status quo. In particular, the new funded elements are often traded for cuts in public pension schemes.

Third, I demonstrate that trade-offs between the fiscal and social dimensions of pension reforms emerge during legislation, and these may jeopardise successful implementation. Excessive emphasis on financial viability and economic competitiveness often conflicts with sound social policy, i.e. producing a pension system that protects the elderly from poverty and provides them with adequate benefits. Conversely, failure to eliminate both extreme imbalances between contributions and benefits, and unjustified special privileges for particular groups, may result in a disproportionate burden for the fiscal budget.

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Finally, how legislation is conducted is important for a reform's political acceptability and the achievement of its multiple objectives. Negotiated bargains are qualitatively very different from other modes of policy making. Contrary to a received wisdom in the literature, I argue that consensual, inclusive decision-making, as opposed to unilateralism or limited bargaining, increases both the effectiveness of reforms and their political sustainability over time. The involvement of a greater number of stakeholders allows for smoother implementation: costly deviations from efficient solutions are more easily avoided, and incentives to stick to the reform's initial design and purpose are put in place.

To substantiate these claims, this dissertation analyses reforms in Croatia, Hungary, Poland and Slovenia. Despite similar and parallel reform processes, these countries have quite different institutional settings, policymaking styles and reform outcomes. Whereas Croatia and Hungary are majoritarian regimes in which policymakers failed to include a majority of stakeholders, Poland and Slovenia are consensual democracies where decision-making was concerted. This affected the political sustainability of reforms: the first two countries have witnessed sharp declines in popular support whereas the latter display reasonable a resilience to policy reversal. The distributive outcomes are likewise diverse: Croatia and Poland overemphasised the financial viability of pensions at the expense of the adequacy of future pension benefits; Hungary and Slovenia failed to fiscally stabilise their public retirement schemes. None has so far struck a fair balance between social, fiscal and political objectives, thereby rendering a rethinking of their reform strategies unavoidable.

With respect to existing work on Central, Eastern and Southeastern European pensions, this dissertation makes two innovations. First, it is the first to extend its analysis to ten years of implementation, following the reform wave of the late 1990s. Second, it links the legislative and the implementation phases together by employing and adapting the theoretical framework developed by Natali and Rhodes for the analysis of pension reforms in Western Europe. This framework considers policymaking as a negotiated bargain between policymakers and the social partners, consisting of complex exchanges between politics and policy. In particular, the two authors distinguish between political (vote-, office- and policy-seeking) goals and policy objectives (financial viability, economic competitiveness, equity and effectiveness). These can be traded against each other, thus expanding the room for manoeuvre available to decision-makers.

The application of this framework to my four cases requires two modifications. First, the dissertation extends the 'time horizon' of analysis to encompass both legislation and implementation. The framework is inserted into a political-institutional context, in order to analyse its influence on the reforms' distributional consequences and political sustainability.

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Second, the actor constellations and policy objectives are adapted to the post-socialist experience. Elite welfare stakeholders, such as the vast state bureaucracy, are included. And certain policy objectives, for example equity, are reinterpreted to give a more accurate picture of the complex political exchanges that underpinned these countries' pension reforms.

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Introduction

This dissertation compares the political economy of pension systems and reforms in four Central, Eastern and Southeastern European countries, Croatia, Hungary, Poland and Slovenia. The study employs a historical institutionalist framework to analyse the policies, actors and institutions that characterised the period between the collapse of socialism and 2008. By doing so, it provides an answer to three crucial questions:

1. Why was systemic reform possible and how was it carried through?
2. What are its distributive consequences?
3. Does it guarantee long-term political support?

Legislation of systemic reforms necessarily entailed more complex and demanding policy and political trade-offs than the parametric attempts that preceded them. The aim of the dissertation is to enumerate and analyse these reforms and their outcomes.

In light of almost a decade of implementation, the distributive consequences of these reforms became visible. The dissertation evaluates whether policymakers managed to resolve the conflicts between fiscal viability and sound social policy.

Finally, the policymaking process is not only about achieving determinate reform outcomes but also about ensuring broad political support. The thesis researches whether decision-makers managed to secure general agreement, or whether the freshly implemented retirement systems are at permanent risk of politically motivated policy reversals.

The importance of providing an answer to the questions above stems from the widespread opinion that, despite fundamental reforms, the newly instituted retirement schemes fail to fulfil their fundamental objectives. A pension system has multiple aims. Households need schemes that provide for adequate retirement income and insure against risks, such as longevity. Governments employ pensions to reduce poverty and to achieve a certain degree of redistribution, for example, in the face of adverse labour market conditions (Barr and Diamond, 2009: 7). These come at a price. Retirement systems have to operate within fiscal constraints and enjoy continuing political support at all levels to be sustainable in time (cf. Barr, 2002: 23; World Bank, 2006: 55). Failure to put in place a 'tripod' that supports the new arrangements, and whose legs are financial, social and political sustainability, jeopardises the correct implementation of pension reforms and permanently exposes them to reversals or popular backlash.

That socialist pension systems were politically abused and overstretched to the point of fiscal breakdown, without satisfactorily fulfilling their social objectives, is a well-known problem. A no-reform scenario was simply not an option. However, the economic soundness of

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the 'new pension orthodoxy' (Lo Vuolo, 1996: 692), fervently advocated by the World Bank and consisting in the partial privatisation of public pension schemes and the tightening of the link between contributions and benefits (Chłoń-Domińczak and Mora, 2003: 132)., is heavily contested. At best, claiming that privatisation is a panacea has evident theoretical flaws; at worst, the cure may be worse than the disease, as the excessive reliance on benefit cuts may end up creating poverty in old age.

Moreover, the arguments on the political insulation of private schemes from political influence were falsified in practice. Existing evidence on reactions against the new paradigm in the two regions that most eagerly embraced it – Latin America and Central, Eastern and Southeastern Europe – shows that the problem is real. In order to resolve it and to avoid its repetition in other would-be reformers, thorough multidisciplinary research is required, not least on the political economy of the reform processes.

Recent evaluations of reformed post-socialist retirement systems expose some lacunae of earlier political-economy analyses. The unprecedented scope and depth of pension system transformation in the East has elicited a vast academic literature. Existing research, however, focuses mainly on the first decade of reforms, in an attempt to explain how systemic shifts were possible and what interests and motives pushed them forward. What remains largely unexplored is the fate of the new reformed systems and the sources of their current problems.

In order to fill this gap, the study extends the period under consideration to almost a decade of implementation. After providing an overview of the early reform phases and introducing a novel explanation for the surprising feasibility in certain countries of paradigmatic reform, this study focuses on implementation to show that reform outcomes may be not only fiscally or socially unsustainable, but will also (under certain conditions) lead to costly deviations from efficient practice and become extremely vulnerable to shifts in political power.

A brief account of the developments so far is needed to expound the main arguments of the thesis. This is followed by the presentation of the four case studies and by a roadmap for the reminder of this dissertation.

The need for reforms

After the collapse of socialism in the early 1990s a triple transition started for Central, Eastern and Southeastern Europe: from central planning to a market economy, from socialism to democracy and from the Soviet bloc to the European Union (EU). In addition, another set of challenges befell the region: the demographic transition marked by rapid ageing and shrinking populations (Chawla, Betcherman, and Banerji, 2007).

Like other transition economies, Central, Eastern and Southeastern European countries inherited inefficient and inequitable public pension systems that already under socialism had experienced severe financial strains. These pressures worsened and became unsustainable during early transition. Already ill prepared to withstand the long-term effects of population ageing, in the context of acute labour market crises, Central, Eastern and Southeastern European pension schemes were overstretched to the point of breakdown.

As a result, between 1989 and 2008, the region's retirement schemes underwent three reform phases. Before the mid-1990s, local policymakers tried to solve the crisis via parametric adjustments. When that failed, a debate on systemic change launched the second, structural reform phase, which culminated in the adoption of paradigmatic reforms in a number of countries, starting in the late 1990s. Although the outcomes vary considerably, Central, Eastern and Southeastern European countries eagerly embraced the abovementioned 'new pension orthodoxy', thereby introducing partial funding and a stricter contribution-benefit link.[1] There then followed a third implementation phase, which saw a fine-tuning of these schemes and the emergence of unforeseen and sometimes critical problems.

Evaluations of the latter period are only slowly being produced. Very recently, the World Bank published a preliminary assessment of reformed Central, Eastern and Southeastern European pension systems, which reveals a rather desolating picture. First and foremost, the Bank points out the importance of simultaneous reforms in labour and financial markets. The new schemes frequently do not guarantee benefit adequacy for partial career workers. Hence, the promotion of longer employment and postponed retirement is crucial. In addition, returns in private schemes swing widely and are more often than not poor. So regulatory and governance practice needs to improve (Holzmann, 2009). The least encouraging assessment is, however, dedicated to the future sustainability of reforms. The Bank warns that financial viability cannot be achieved just through fine-tuning, and also cautions that reforms relying excessively on internal savings, e.g. through reduction of future entitlements, may soon lose popular support (Holzmann and Guven, 2008: 39-42).

The main aim of this thesis is to give a political interpretation of the developments above. This involves the creation of a unified analytical framework, which encompasses all three reform periods and simultaneously answers the dissertation's research questions.

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[1] Public Pay-As-You-Go (PAYG) Defined Benefit (DB) schemes require a change in their calculation formulae to be actuarially fairer. Point systems and Notional Defined Contribution (NDC) schemes are some of the available options.

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Reform feasibility

In order to address the first question on the feasibility of systemic reforms in post-socialist countries, the literature dealing with pension systems in Europe's conservative-corporatist regime of countries offers useful insights.

Post-socialist social security shares similar policy problems and institutional characteristics. The transformational recessions shattered these schemes' foundational assumptions: population growth came to a halt, the centrally planned or self-managed economies fell to pieces, and the fundamental mismatch between demand and supply of labour skills generated unemployment, redundancy and widespread exit from the labour market. Moreover, the inherited schemes are endowed with an institutional structure that is resistant to reform. Although social welfare was popular, as it fully covered an underemployed and overstretched workforce, it was also fragmented, since jobs useful for the 'advancement of socialism' were granted special privileges. Social security schemes were contribution-financed and managed by trade unions, a vast bureaucracy and large state-owned enterprises.

Post-socialist Pay-As-You-Go (PAYG) retirement systems soon became the hottest item on the political agenda, as they combined the worst aspects of the transformational crisis and the most sclerotic institutional structure. Almost a decade of policy paralysis was interspersed by unsuccessful attempts at refinancing. The latter were soon discontinued, due to international competitiveness concerns, and were followed by deeply unpopular retrenchment, thus opening the door to structural reform.

The new pension paradigm embodies a flexible multidimensional reform concept. This gives policymakers enough room for manoeuvre to accommodate opposing vested interests nested within a pro-welfare coalition consisting of trade unions, pensioner associations and a strong, over-bureaucratised public administration (e.g. Cook, 2007: 18). This dissertation demonstrates the centrality of negotiated bargains for the success of systemic pension reforms, which are, similarly to reforms of Bismarckian schemes (see Natali and Rhodes, 2007), underpinned by a complex process of political exchange that diminishes or neutralises opposition.

Reform sustainability

Ten years into implementation show, however, that actual reforms are qualitatively very different from each other. Apart from the institutional consequences of legislation – the World Bank's blueprint has been interpreted and tailored according to the needs of individual countries, see Orenstein (2008: 47-49) and World Bank (2006: 4-6) – Central, Eastern and Southeastern European pension systems score dissimilarly on three dimensions: their current and future

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political, fiscal and social sustainability. Regrettably, none of the reforms seems to have so far struck a satisfactory balance between the three objectives.

To answer the second and third research questions requires assessing how the chosen cases perform on each dimension, and this in turn requires tracing the origins of current problems back to the decision-making process. In particular, the thesis draws a distinction between the political sustainability of reforms, and the trade-off between fiscal and social sustainability.

Political sustainability is a *conditio sine qua non* for future success of Eastern pension reforms. Barr (2002: 23) contends that successful reforms require continued political support at all levels: by policymakers, by the administration and by the public at large. This in turn depends on the policymaking style, which is influenced as much by individual actors' conduct as by the political-institutional structures in which these policymakers operate.

Post-socialist democracies present a wide array of institutional structures, ranging from pluralitarian to consensual. This crucially affects the leeway enjoyed by individual executives. Within these settings, policymakers have limited ability to decide whether to involve or bypass organised interest groups, heed or ignore external recommendations, and co-opt or neutralise veto actors. The decision to swiftly push the reforms by resorting to limited bargaining, as opposed to inclusive policymaking, may come at a price. As Haggard and McCubbins (2001: 6) aptly point out, there is a fundamental trade-off between the capacity to adapt policies to changed socio-economic circumstances, and the consistency with which the policy is implemented, that is, between reform capacity and its subsequent stability. Many Eastern pension reforms 'derailed' as soon as implementation started, and this may be (at least in part) imputed to reckless and divisive decision-making.

A correct equilibrium between the fiscal viability and social fairness of a reformed pension system represents the basis for its economic and normative legitimation. When pension schemes create deficits, they crowd out other necessary forms of social spending (e.g. education, health care, and other forms of insurance); and they may hinder a country's international competitiveness, as well as reduce the potential for economic growth. Yet if popular expectations of high (or at least adequate) benefits are betrayed, this may soon lead to a general backlash against reforms (see Brooks, 2006: 26-29). The balance between the two dimensions depends almost entirely on the complex trade-offs that make legislation possible.

The new pension paradigm is primarily aimed at financially improving traditional PAYG systems that have spun out of fiscal control. It also advocates the introduction of individual funded accounts, which aggravate a pension system's fiscal imbalance in the short term (due to the diversion of pillar-specific contributions). In order to maintain overall financial balance of

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these schemes, multipillar reforms entail a departure from redistribution towards stricter correspondence between contributions and benefits. This is a decisive move towards a more liberal welfare state model where residualism predominates (Esping-Andersen, 1990; Orenstein, 2008: 18), and which may have inauspicious social consequences. If the vulnerable elderly are not given sufficient attention, as frequently happened (e.g. World Bank, 2006: xv-xvi), and if pension benefits are the only variable that is endogenously adjusted to keep the system fiscally sustainable, then both fundamental social objectives – poverty alleviation and consumption smoothing – are not being fulfilled.

This means that a systemic overhaul of inefficient and excessively generous public schemes requires a careful understanding of its distributional impact, the individuation of the winners and losers of reforms, and clear rules governing the redistribution of wealth from the former to the latter group of insured persons, as the Independent Evaluation Group forcefully pointed out (World Bank, 2006).

Hence, in line with the Bank's recent warnings, all reforming countries face a trade-off between these two dimensions of sustainability. In particular, those countries that achieved the acquiescence of the pro-welfare coalition by shielding it from benefit cuts, at the expense of less protected groups, risk the social instability of retirement arrangements. Yet others that did not resort to such *quid pro quo* (frequently due to insufficient resolve) may be exposed to the fiscal imbalance of their pension systems.

This research assesses each case to determine which course had been chosen, what its consequences may be and what corrective policy options are at disposal. Given the spread of similar policies across the whole region, the analysis of the consequences of implementation in early reformers provides valuable information for all other countries, and especially for those that are still planning to restructure their strained retirement systems.

The four cases

Croatia, Hungary, Poland and Slovenia are a subset of Central, Eastern and Southeastern European countries, which shared at the beginning of the 1990s similar problems linked to old-age retirement. After a number of attempts at refinancing and retrenchment failed in each of these countries, they almost simultaneously legislated fundamental reforms in the years 1997-1999. In comparison to the rest of the region, they are all reform precursors.

The policymakers in Croatia, Hungary, Poland and Slovenia resorted to negotiated bargains with conflicting trade-offs to win over the defenders of the status quo. However, the modes of negotiation and consequently the policy outcomes differ substantially across the four cases.

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The four transition economies inherited very diverse political-institutional structures from socialism. Croatia was until 2000 a limitedly pluralist 'demokratura', Hungary an unconstrained dictatorship of the majority, Poland a parliamentary democracy under the spell of 'politico-corporatist entities', and Slovenia a neocorporatist social-democratic state. These institutional arrangements very much influenced the policymaking process.

Croatian and Hungarian unconstrained executives resorted to divisive policymaking and limited, clientelistic bargaining: the former neglected most civil society groups, while pampering its most valuable constituencies, and the latter treated pension reforms as an internal affair of the ruling coalition. Both countries introduced elements of the new pension orthodoxy and Croatia even transformed its old PAYG public scheme into an actuarially strict point system. By contrast, Poland and Slovenia were forced to negotiate with the most vociferous elements of the pro-welfare coalition, as various previous reform attempts ended in protracted political gridlocks. Slovenian politicians did not display enough resolve to contest organised interest groups and produce an all-encompassing reform. However, privatisation did not slip off the agenda and was partly carried out by 2003. Polish policymakers went farthest of all. They extensively involved major stakeholders and created an encompassing reform that rewrote the social contract between the state and its citizens. Not only did they partly privatise Polish retirement, they also turned the public PAYG scheme into a Notional Defined Contribution (NDC) system with limited redistributive elements.

These approaches resulted in markedly different implementation strategies and consequences. By excluding from negotiations some key stakeholders, the newly legislated pension systems in Croatia and Hungary enjoyed only narrow political support, which deteriorated from the very beginning. In addition, they contained design flaws that rendered the systems vulnerable to economic populism. The Hungarian retirement system currently has, as a result of policy reversals unleashed through extreme political budget cycles, poorer fiscal prospects than at the onset of reforms. Worse still, unrestrained Croatian reformers excessively relied on internal savings to reduce public pension spending and to maintain various privileged pensions intact, so potentially pushed less favoured elderly into abject poverty.

It is true that the Polish and Slovenian reformed pension systems emerged relatively unscathed from critical difficulties and shifts in governmental power; however, neither is perfectly prepared for long-term demographic consequences. Whereas Polish reformers enhanced its welfare state's male breadwinner model and aggravated the insider-outsider structure of the labour market, thereby putting under question future benefit adequacy, Slovenian reformers did not go far enough. The tiny republic's retirement system is relatively generous, redistributive and unprepared for population ageing. The tightening of the contribution-benefit

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link, elimination of unwarranted privileges and a higher pensionable age should soon enter the agenda to prevent the public scheme's future fiscal collapse.

A roadmap

In order to develop the arguments above, the dissertation is structured as follows. The first chapter develops the research design and theoretical framework. After briefly illustrating the new pension orthodoxy and its impact on socialist pension systems, the chapter explains why a most similar system design is feasible and apt to accommodate a theory explaining the divergence in reform outcomes and their implementation.

An actor-centred institutionalist framework is developed to link the institutional setting, the mode of negotiation and the reform outcomes into a coherent whole. To substantiate this choice, previous literature is discussed and compared to the employed solution. The four cases, Croatia, Hungary, Poland and Slovenia are introduced and their role in the overall thesis is expounded. The research material and sources are presented.

Chapters two to five analyse the single case studies one by one. Each chapter locates the country in the general framework and discusses briefly its political and economic transformations, institutional setting and pension system history. The early attempts at parametric reforms are described and the structural overhaul is thoroughly analysed. Since, however, earlier studies devolved much energy to this task, the dissertation builds upon their accounts and mainly focuses on the reform's implementation, current problems and future challenges. Links are established between the three dimensions of policy outcomes and the trade-offs present in the negotiated bargains.

The sixth chapter presents the comparative conclusions to the study. The chapter gives a broad overview of the four cases and the political economy of their pension reforms and implementation outcomes, and therewith summarises the findings of the dissertation.

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I. The theoretical framework

Introduction

The neoliberal trajectory that transition welfare states embarked upon, and in particular the unprecedented diffusion of partial pension privatisation, have elicited a substantial amount of research on Central, Eastern and Southeastern European social policy. Although many disciplines gave fundamental contributions to the debate, this chapter focuses on the comparative welfare state literature, which emphasises that 'politics matters' (for a detailed literature review, see Cook, 2007: 4-22; Immergut and Anderson, 2007: 4-17).

These studies argue that political institutions mediate the impact of socioeconomic changes, which alone are unfit to explain the different trajectories of policy change. Various comparative studies of welfare state reforms, and the subset that deals with retirement policies in the East, stress the importance of two distinct factors in policymaking: i) common policy legacies constraining future policies and empowering constituencies for and against reforms; and ii) the interaction between political institutions and policymaking actors, both domestic and transnational.

The dissertation's research design is located within this literature and adopts an actor-centred (historical) institutionalist perspective to study the political economy of pension reforms. For this purpose, it adapts the framework developed by Natali and Rhodes (2007) for 'corporatist-conservative' regimes of countries.

The theoretical 'spillover' is justified on multiple grounds. First, sufficient analogies exist between the institutional structure and the mounting problems of Continental retirement arrangements (predominantly employment- and income-related Bismarckian), and post-socialist pension schemes. Second, this approach is very suitable to shed light on the unprecedented popularity of systemic pension reforms in the region. By focussing on the 'creative opportunism' of policymakers, it shows how and for what purpose these were able to simultaneously introduce policy improvements and impose benefit cuts. Finally, the framework is easily extended to the implementation of reforms, thereby providing a sound basis to link individual decision-makers' preferences to policy outcomes and consequently assess their sustainability in time.

Following the two authors, reforms are legislated as a result of complex, negotiated bargains, after the room for manoeuvre to carry out simpler measures, such as refinancing and retrenchment, shrinks to non-existence. These negotiated bargains involve multiple trade-offs between conflicting policy goals and contrasting actors' strategies in both the political and corporatist arenas.

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Given the severity of the transition-induced crises and the existence of a popular 'negative consensus' against inherited pension systems, the new pension orthodoxy gained legitimacy and desirability in the eyes of national officials (Orenstein, 2008: 70; Brooks, 2006). By virtue of its innovativeness and flexibility, the reform blueprint advocated by the World Bank during the 1990s found fertile ground in Central, Eastern and Southeastern Europe. Oversimplifying the argument, exploitation of the multidimensionality of structural reforms frequently allowed policymakers to employ the new funded element's popularity and trade it for cuts in the public retirement systems.

The nature of the bargains that rendered these systemic overhauls possible had major repercussions on the reformed systems' distributive outcomes, political sustainability and stakeholder compliance. In order to include a decade of implementation, the original theoretical framework must be revised and extended above and beyond legislation. In fact, neither the literature on welfare states in transition economies nor more generic research has systematically analysed the implementation of reforms from a political economy perspective. Only recently, the World Bank and some individual scholars observed that the inability of the new designs to satisfy popular expectations have generated pre-emptive, frequently inadequate political responses. In addition to the necessary amendments to accommodate for the different actor constellations in Central, Eastern and Southeastern Europe, two upgrades of the Natali-Rhodes framework are here proposed.

First, the analysis of policymakers' negotiating style allows for the assessment of the political sustainability of reforms in time. Key to the thesis is the proposition that pension reforms involving limited bargaining by unconstrained executives also have the weakest foundations and are at permanent risk of institutional breakdown. Politically motivated policy reversals and deviations are thus explained by the divisiveness of the policymaking process, which neither allocates evenly the costs and benefits of reforms, nor creates the incentives to stick to the determined reform path.

Second, the decomposition of both the political and policy spaces into separate dimensions is very useful to identify the links between political preferences and specific policy goals, whose impact can be appreciated only after legislation. Excessive emphasis on the system's financial viability and its effects on economic competitiveness may penalise unprotected individuals and render pension reforms socially unsustainable. Conversely, the inability to eliminate unjustified special privileges and the failure to reduce the excessive disconnection between contributions and benefits in public schemes, may result in a disproportionate burden for the fiscal budget, for the production regime's competitiveness or for both.

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The chapter begins with the delineation of Natali and Rhodes' theoretical framework. The framework is consequently extended from legislation to reform implementation and adapted to the post-socialist context. The choice of this framework is then substantiated through a brief overview of post-socialist pension systems, their crises and reform outcomes, as well as the political economy literature on the topic. The chapter concludes by providing a detailed overview of the four cases and how they are structured and analysed in the remainder of the dissertation, both individually and in comparative perspective.

The political economy of pension reform

In a key contribution, Weaver (2004) posits that the only ways to reform a fiscally troubled public PAYG system are: i) refinancing through higher contributions; ii) retrenchment by lowering monthly benefits or through stricter eligibility requirements, e.g. an unchanged monthly pension starting at a later age; iii) restructuring the scheme's underpinning logic. From a wider perspective, refinancing and retrenchment alter either the setting or the nature of retirement policy instruments. Hence they qualify as first-order, instrumental or second-order, parametric changes. Restructuring is instead a third-order, paradigmatic change characterised by simultaneous reform in both senses as well as of the system's overall goals (Hall, 1993: 278-279).

In theory, paradigmatic reforms should be more difficult to legislate and implement. During the legislative phase they require very complex decision-making strategies and they pose additional challenges during implementation, as they presuppose changes in an institution's formal rules, sanctions, benefit promises and actor expectations. Therefore, it is surprising that the analysis of Central, Eastern and Southeastern European pension reforms shows exactly the opposite, i.e. that changing the underlying paradigm and adopting solutions foreign to these countries' social policy traditions was paradoxically easier than tuning the parameters of the old schemes.

Following most contemporary interaction-oriented research, a historical institutionalist frame is chosen to explain the conundrum. Natali and Rhodes' (2007) theoretical setup neatly falls into this category, in line with many other studies on the political economy of retirement.

In the words of Scharpf (1997: 36), the choice of interaction-oriented actor-centred institutionalism allows for: *"a 'better goodness of fit' between theoretical perspectives and the observed reality of political interaction that is driven by the interactive strategies of purposive actors operating within institutional settings that at the same time enable and constrain these strategies."* Its most important feature is the ability to distinguish between policymakers – who process interest group demands and intellectual innovations – the organisation of the state and

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policy legacies, by identifying those relevant institutional features of the environment that enable or constrain actors' behaviour and choices.

Although concerned with the effects of decisions by domestic policymakers, the present study does not ignore Orenstein's (2008: 177-178) admonition to historical institutionalists and recognises a strong proposal role to international organisations, especially during agenda setting. Orenstein argues that historical institutionalism typically analyses how national policy elites react differently to similar transnational trends, for example to Pierson's 'irresistible forces'. The investigation of the global pension privatisation campaign, however, shows that transnational policy actors have a substantial impact on policy, despite differences in domestic actor constellations and institutions, and their influence should thus be taken seriously.

The double trade-off in politics and policy

Natali and Rhodes' main argument stems from the observation that, in contrast to the welfare state's 'immovable objects' – defined by Pierson (1998: 551) as: *"the electoral incentives associated with programs which retain broad and deep popular support and the institutional 'stickiness' which further constrains the possibilities for policy reform"* – reform is happening and not only in the form of radical retrenchment.

The authors make two claims for the conservative-corporatist regime of countries, which are relevant to this dissertation. First, they posit that central to recent welfare state reform are political exchanges and trade-offs, which play a major role in resolving distributive conflicts (in the political and corporatist arenas) and hence increase the room for manoeuvre for policymakers. Second, they contend that the strategies involved need not be associated only with 'blame avoidance' tactics (Weaver, 1986; Pierson, 1996), since policy innovations, such as the increased reliance on private pension arrangements, allow policymakers to claim credit for introducing them.

Natali and Rhodes imagine a double trade-off taking place in the policy and political/corporatist domains. They propose the distinction between four different policy objectives in recasting Continental welfare states: i) financial viability – in light of ballooning costs and the confusion between social assistance and social insurance; ii) economic competitiveness – jeopardised by high employer contributions and low labour participation rates; iii) equity – a response to the uneven distribution of protection across risks and groups; iv) effectiveness – to prevent vertical and horizontal leakages and to provide more benefits with less resources.

As for the more tangible aims of policymakers, these follow Rosa Mulé's (2001) analysis of political parties and extend it to the social partners, thereby espousing the view that the main

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locus of negotiations has gradually moved to the corporatist arena.[2] In their framework policymakers act as:

i. vote-seekers – politicians win electoral support and control government; social partners maintain the support of affiliated political parties;
ii. office-seekers – politicians retain control over political office in their quest for benefits and private goods; social partners continue managing social security schemes;
iii. policy-seekers – both politicians and social partners represent particular groups, in line with social cleavages and insider-outsider divisions.[3]

Careful 'political exchanges' between the two arenas (political and corporatist) and between the four policy aims can exploit their multidimensionality to increase the room for manoeuvre to policymakers. This allows the possibility to trade the dimensions with one another. The results are different types of packaged solutions (sometimes not confined to pension reforms) that allow for proper systemic overhauls.

This study argues that the two authors' claims by and large hold in transition economies. In this context, the dissertation espouses the view that paradigmatic reforms are politically superior to parametric reforms, despite their doubtful economic superiority. As a result, the first two propositions of the thesis show substantial similarities with the work by Natali and Rhodes:

P1: *As the possibilities to enact simple corrective measures (refinancing and retrenchment) to post-socialist retirement systems shrink to non-existence, policymakers engage in negotiated bargains, which increase their room for manoeuvre vis-à-vis the pro-welfare coalition. Complex political exchanges become central for the restructuring of these public schemes.*

P2: *Paradigmatic reforms that seek to introduce policy innovations, such as funded elements into a PAYG system, enjoy greater policy multidimensionality than parametric reforms. Hence, these negotiated bargains involve credit-claiming tactics as much as blame avoidance strategies. In particular, the new funded element's credit-claiming potential is often traded for substantial cuts in public pension schemes.*

The framework, however, needs various adjustments. In the next paragraphs, its structure is extended to the implementation phase and the definitions of fiscal, social and political sustainability are provided. To be then applicable to Central, Eastern and Southeastern Europe, the theoretical construction is adapted to the post-socialist context.

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[2] Bonoli (2000: 37-38, 2001: 241) plainly states that in Continental Europe the pro-welfare coalition tends to coincide with the labour movement.

[3] Green-Pedersen (2003: 31-33) contributes to the argument by claiming that the three goals do not have equal weight: office-seeking is frequently *primus inter pares* for both politicians and social partners. Politicians and union leaders want to govern: hence, policies are subordinated. Gaining votes has usually equal standing as retaining office. Only rarely do incumbents sacrifice electoral popularity.

Extension to implementation

The decomposition of the policy and political spaces individuated above not only gives precious insights on how reforms are legislated, it is also easily extendable to the implementation phase. The analysis of which policy aspects have been focused on during legislation individuates the losers and the winners of reforms, as well as the temporal distribution of gains and losses. These in turn provide very precise indications on the strains generated within the new pension systems, and whether they are sustainable in the long term.

What is of interest for this thesis is the social, fiscal and political sustainability of reformed retirement arrangements, a 'tripod' that should support fundamental reforms. The first two directly emanate from the policy trade-offs during legislation and hence do not require specific extensions of Natali and Rhodes' framework. The latter instead demands the explicit incorporation of the decision-makers' negotiating style and the political-institutional structures within which policymakers operate. These determine the degree of authority concentration of the executive, its reform capacity and hence the political sustainability of its policies.

Fiscal and social sustainability

The fiscal and social sustainability of a pension system are two sides of the same coin, or, as Barr (2006: 68) puts it for actuarially strict schemes: *"[fiscal] sustainability is in conflict with sound social policy."* For a decade, the World Bank (2006) stridently advocated privatisation and a strict actuarial relationship between contributions and benefits, but after mounting empirical evidence had to acknowledge the importance of this trade-off. In a recent evaluation of nine Central, Eastern and Southeastern European reformed retirement systems (Holzmann and Guven, 2008), the Bank concluded that:

i. Reforms may be fiscally unsustainable. While there are ways to increase the financial viability of public pensions (increased revenues, lower benefits, higher retirement age), these are no panacea for actuarially unbalanced schemes.
ii. Reforms may be socially unsustainable. Internal savings in public schemes may lead to inadequate benefits if they are overused to finance the transition to a funded pillar and to achieve the fiscal balance of unfunded schemes.

In order to understand the nature of the trade-off, the workings and inherent problems of traditional PAYG schemes need to be spelled out. Despite being relatively easy to set up, PAYG public pensions are very vulnerable to demographic assumptions. Moreover, if they are based on defined benefit formulae, the provider (the government) is relatively more exposed to risk than

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in systems based on defined contributions (Thompson, 1998). These penalise the insured that do not have sufficient contributory records, through the endogenous adjustment of their benefits.

Defined benefit schemes are often advantageous to the first generation adopting them, but if not designed with the required precautions, may experience harsh fiscal problems when the System Dependency Ratio (SDR), i.e. the ratio between contributors and pensioners, starts to increase (Brooks and Weaver, 2006: 350). In addition, these schemes are prone to moral hazard by politicians, who promise more than the state can deliver in future (Orenstein, 2008: 77-78).

These inherent problems (ageing) and deliberate abuse (political moral hazard) increase the implicit debt of a public retirement system, defined as the net present value of accrued rights of current workers in the old system (Brooks and James, 2001: 138-139). If the mounting financial strains are not matched with higher contributions or lower benefits, then the pension system starts to generate deficits, which require additional injections of taxpayer money.

Fiscal sustainability thus becomes an inherent characteristic of a pension system. Of the two paradigmatic shifts advocated by the World Bank, i.e. advance funding and a stricter contribution-benefit link, the former is unable to reduce the demographic or moral hazard problems affecting public schemes (Barr, 2002; Barr and Diamond: 2008: 211). Actually, private funds are more tempting for politicians, since these schemes accumulate many years of contributions, as opposed to one year in PAYG plans. Tightening the linkage between contributions and benefits then represents a reasonable solution, but still has to be planned and used with extreme care.

Moving from a loose defined-benefit setup of public schemes to calculation formulae that more firmly link contributions to benefits (for example point systems, as in Germany or France, or Notional Defined Contribution systems, as in Italy and Sweden) helps a great deal. Reformers that moved into this direction experienced dramatic improvement in the future fiscal prospects of their pension schemes.

However, reforms that overemphasise the system's fiscal sustainability and neglect broader public policy goals, namely poverty relief (both permanent and transient) and distributional objectives (covering temporary periods outside the labour market or subsidising the consumption smoothing of people whose earnings are just above the poverty line), may result in the social unsustainability of these schemes.

If the only endogenous variable by which the system is adjusted to changing circumstances (life expectancy, employment growth, productivity growth) is the pension benefit, then in the limit it pulls everyone down to the minimum pension (Barr, 2006: 68). Brooks argues (2006) that this may lead to the betrayal of beneficiaries' expectations and the normative

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delegitimation of the newly introduced pension systems, thereby increasing the likelihood of popular backlashes and policy reversals.

A thorough assessment of the distributional consequences of recent reforms is out of the scope of this study and would require very precise micro simulations (see Meyer and Bridgen, 2007) This dissertation infers from the political economy of pension reforms their broad distributive outcomes, with the aim of determining whether the policy dimensions financial viability and economic competitiveness were considered more important than equity and effectiveness.

Hence, the third proposition of this study is:

P3: There are fundamental trade-offs between the fiscal and social dimensions of pension reforms. Excessive emphasis on financial viability and economic competitiveness may conflict with sound social policy. Conversely, the inability to eliminate unjustified special privileges and failure to tighten the contribution-benefit link in public schemes may result in a disproportionate burden for the fiscal budget, for the production regime's competitiveness, or for both.

Political sustainability

As for the political soundness of reforms, two issues stand out. Since reform is a process and not an event, successful legislation is no indicator that smooth implementation will follow. Continued support is necessary at all levels: by policymakers, the administration and the public at large (Barr, 2002: 23). Hence, systemic overhaul of a socialist PAYG scheme requires an open renegotiation of the social contract (Brooks, 2006), which should be the guiding principle of every major reform.

From this point of view, the political exchanges that took place in Central, Eastern and Southeastern European countries are qualitatively very different from one another. If certain countries effectively engaged in encompassing bargaining, thereby including the majority of stakeholders, others resorted only to limited negotiations, involving just their narrow constituencies and mainly aimed at short-term electoral goals.

Such qualitative diversity between bargains has of course major implications. Standard veto actors literature (Tsebelis, 2002) recognises that reform capacity and political stability are conflicting policy characteristics. Haggard and McCubbins (2001: 6) posit that: *"[a] more decisive polity must necessarily be less resolute."*, which is equivalent to saying that the higher the capacity to adapt policies to changed socio-economic circumstances, the lower the consistency with which the policy is implemented.

Other scholars, however, question this argument and suggest there is a positive relationship between policy stability and its adaptability to changing socioeconomic circumstances. For example, Bonoli (2001: 263) argues that: *"the institutional constraints which*

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limit the scope for unilateral reforms in power-fragmented systems, might encourage an adaptation process which combines retrenchment with a modernization of the welfare state, or measures designed to take into account new social demands." More pessimistically, Immergut and Anderson (2007: 8) argue that: *"the analysis of pension politics raises some troubling issues for veto points/veto players theories."* Among others, the authors dispute the alleged decisiveness of concentrated authority, which frequently falls prey to narrow clienteles, and propose to supplement veto actors with a theory of political competition.

More formally, Scartascini, Stein and Tommasi (2008) update the veto players theory and claim that, once an intertemporal dimension is brought in, there is a positive correlation between policy adaptability and its stability (Scartascini, Stein, and Tommasi, 2008: 22):

> *"A more decisive polity not necessarily must be less resolute. There are some forces (of different equilibria in repeated-interaction contexts) leading to a positive association between decisiveness and resoluteness (adaptability and stability).*
>
> *Many veto players do not necessarily make significant policy changes difficult or impossible. There are some channels through which more veto players increase policy adaptability."*

The authors mention several channels by which more veto players can lead to more cooperation, e.g. more players sitting at the same table may render opportunistic behaviour more costly; my willingness to give in today (and hence cooperate) may be spurred by the likelihood of future collaboration, when reallocation may be favourable to me, etc.

This dissertation espouses the latter view and argues that the key difference lies between divisive and inclusive policymaking. Including current effective and future potential veto and proposal actors into all negotiation stages has advantages, despite longer periods of time required for reform legislation. Gains and losses – and hence both the blame and the credit for reforms – are more evenly spread among various actors. Limited bargaining may generate just the opposite results: reforms may be swifter, but opportunistic behaviour becomes more likely. The implications are obvious.

Costly deviations during the legislative phase that may lead to short-term political advantages are more readily avoided when more players sit at the policymaking table. Hence, the adaptability of the policy to changed socio-economic circumstances is greater, as both the feedback to the agenda-setter and its responsiveness to various needs increases. Shared blame and credit also render more costly any future deviations from the undertaken path, especially in terms of the credibility of those actors who would renege on their own policy proposals.

Conversely, divisive policymaking renders opportunistic behaviour more likely, during both legislation and implementation. During legislation, policymakers find it easier to unevenly distribute gains and losses and extract short-term political advantages. This not only means that

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costly deviations may undermine the correct adaptation of policy to socio-economic needs, but also that future policy reversals become less onerous. Since political power of different actors varies over time, those who were excluded from reforms may find it advantageous, once endowed with authority, to redistribute resources in their favour, thereby weakening the credibility of previous commitments.

This introduces the fourth, and final, proposition of this study:

P4: Negotiated bargains are qualitatively very different one from another. Inclusive policymaking, as opposed to limited bargaining, may increase both the adaptability of reforms to changing socioeconomic circumstances and their political sustainability in time. Costly deviations from efficient solutions (e.g. the uneven distribution of gains and losses) are more easily avoided and incentives to stick to the reform's design are put in place.

In order to explore the proposition above, it is necessary to integrate Natali and Rhodes' framework. The following paragraph introduces a way to determine whether bargaining is more or less inclusive. In addition, it introduces those institutional characteristics of the political system that influence the conduct of policymakers vis-à-vis other stakeholders.

Inclusive versus divisive policymaking

The operationalisation of the two policymaking styles is rather simple. Inclusive policymaking is present when the opinions and views of participating actors, other than the agenda-setter, are taken into account by the latter. Failing that, opposing actors are more likely to mobilise at later stages, for example during implementation, and reverse the reforms (see Orenstein, 2000: 14-17). It is important to note that bargaining may result in the dilution of reforms; however, this is a minor evil against the backdrop of negotiation failure.

Divisive decision-making[4] is instead operationalised through the construction of a counterfactual, that is, by the imaginary application of inclusive policymaking to the same reform process. By doing this mental experiment, it can be shown that certain choices would have been impossible under inclusive decision-making, and hence would have not led to the mobilisation of opposing actors at later reform stages.

The choice between the two bargaining styles is, however, not arbitrary. Even though unilateralism is an ever-present fallback option, (Scharpf, 1997: 99), there are structural conditions that severely limit the conduct of policymakers. The institutional setting of a country determines the number of institutional veto points. Lijphart (1999: 2-4) famously developed a composite index of democracy, which ranks countries from majoritarian to consensual.[5]

[4] I use interchangeably the terms divisive decision-making and limited bargaining.
[5] Other, not dissimilar classifications are possible, see e.g. Powell (2000).

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A majoritarian democracy usually generates fewer veto points than a consensual one. Not only is more limited bargaining likely to occur in the former, it also has higher chances to complete the legislative phase. If instead policymakers resort to divisive tactics in a polity ripe with veto points, this can be much less effective. Orenstein's warning that excluded actors activate at later stages may come true and lead negotiations to non-agreement. The inverse option, i.e. inclusive policymaking in a majoritarian setting is also possible, for example if the incumbent government is weak vis-à-vis the pro-welfare coalition.

In a now classical analysis of the institutional effects on welfare state reforms, Bonoli (2001: 261-262) argues that power concentration may be rather useless for governments if offset by electoral results that, for instance, generate a minority government, thwarted by a strong pro-welfare coalition or counterbalanced by excessive concentration of accountability.

Elections may generate minority governments and governments with small majorities, which face greater problems in controlling policy and are obliged to seek broader consensus than governments counting on larger parliamentary majorities (Bonoli, 2001: 240). A strong labour movement may represent a veto point that even unconstrained executives should not ignore. Reforms not involving *quid pro quos* may excessively concentrate the blame on the executive. In all these cases, inclusive decision-making should be considered. At the same time, supermajorities in parliament and weak social actors may tempt reformers in consensual democracies to try and force legislation through, for instance, by resorting to limited bargaining and neutralisation tactics.

In all these cases, electoral results and the strength of the pro-welfare coalition influence policymakers in their decisions to resort to divisive or inclusive bargaining. Once all these variables are taken into account, one should expect the outcomes in Table I.1.

Table I.1 Institutions, policymaking and outcomes

		Composite index of democracy	
		Majoritarian (unconstrained executive authority)	**Consensual (constrained executive authority)**
Policymaking style	**Divisive**	Politically less sustainable agreement Swift adoption Concentrated gains/losses Lower stability during implementation	Non-agreement Stalemate Excluded actors may block reforms Severe dilution may follow
	Inclusive	Politically more sustainable agreement Lengthy adoption Diffuse gains/losses Higher stability during implementation	

Throughout the previous paragraphs, the dissertation adopted Natali and Rhodes' framework and added a number of extensions required to answer the three research questions. Why was reform possible and how was it carried through? What are its distributive consequences? Does it guarantee long-term political support?

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However, as pointed out before, there are differences regarding policy legacies, actor constellations and institutional structures between Central, Eastern and Southeastern Europe and the 'conservative-corporatist' regime of countries. These do not require a radical modification of the whole theoretical framework, yet have to be taken into account in order to present a realistic picture of the last two decades of pension system reforms and their implementation in the region. The presentation of the post-socialist reality and the review of existing literature on the political economy of retirement follow.

The post-socialist context

Generally speaking, the basic tenets of Natali and Rhodes' framework hold for Central, Eastern and Southeastern Europe. The acute pension system crisis elicited a lively debate that encompassed all four policy dimensions: the financial viability of the region' overstretched PAYG schemes, their negative impact on labour markets and economic competitiveness, the inequalities resulting from half a century of incremental change and their low effectiveness.

The reform of social security was, however, not seen as a priority. Most welfare state modernisation was in fact postponed until the second reform wave, during which 'windows of opportunity' or 'extraordinary politics' were not available any longer and gave way to less heroic 'politics as usual' (see Balcerowicz, 1994). Within this context, policymakers and social partners acted strategically as policy-, office- and vote-seekers, aiming to maximise their material objectives.

Although it is true that Eastern countries inherited from socialism *de facto* Bismarckian schemes that developed similar problems during transition, existing research identifies significant differences between East and West. Following historical institutionalists, these focus on the influence of policy legacies and political-institutional structures on (Weir and Skocpol, 1985: 119): i) the demand for reform instruments (politically expressed demands of social groups); ii) the supply of said instruments (policy-relevant intellectual innovations); iii) the mechanism connecting the two (activities of politicians and officials).

As a result of flawed past policies, the transition-induced crisis was such that both the public and policymakers were looking for innovative solutions to restructure the ailing welfare state, such as those provided by transnational policy actors. A majority of the working population shared a 'negative consensus' against the inherited pension systems (Brooks, 2006: 26). The overstretched nature of socialist labour markets and the differential treatment of various work categories implied that transition-induced problems exalted the differences between insiders, a privileged minority, and outsiders, the vast majority of insured. Hence, post-socialist welfare states not only bred dense networks of support but also widespread dissent.

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In addition to the crisis, the preparedness of domestic elites was very low. The availability of traditional policy instruments (retrenchment and refinancing) dried up almost immediately, leaving policymakers in a state of uncertainty, which heightened the responsiveness of domestic decision-makers to any policy options, even to those not falling within their social policy practice (see Orenstein, 2008: 169-170).

The political-institutional structures inherited from socialism represented fundamental constraints for the activities of policymakers. Socialist regimes were characterised by varying degrees of limited pluralism and the extrication paths of their elites shaped the future characteristics of their democratic and capitalist institutions (see Kitschelt et al., 1999; Stark and Bruszt, 1998; Bohle and Greskovits, 2007). The nature of the transformation from socialism to democracy has to be properly analysed, as the ensuing structures are key to determining the actor constellations that have access to the decision-making process and the reform capacity of policymakers under different democratic configurations.

In general, emerging party competition is helpful to determine the locus where these interactions take place. Two contrasting views exist on the crystallisation of societal cleavages in Central, Eastern and Southeastern Europe. Whereas Mair (1997) offers a pessimistic outlook, where divides do not stabilise into cleavages, Kitschelt et al. (1999) and Lewis (2001) are more optimistic. According to them stabilisation takes time but eventually emerges. In reality, it appears that a clearly discernable Left-Right divide did not readily surface. The sense of economic disaster and lack of programmatic alternatives (see for example Innes, 2002) depoliticised the issue of welfare state reform in Eastern as much as in Western Europe (Orenstein, 2000: 61).

Hence, the main locus of negotiation was the corporatist arena in post-socialist countries as well, thereby entailing *quid pro quos* that had little to do with policy. However, the similarities with Western Europe stop here. The actor constellations, especially those constituting the pro-welfare coalition, did not entirely coincide. The labour movement, in fact, got discredited and lost substantial influence during transition. Consequently, other defendants of the status quo have to be considered: the consent of elite welfare stakeholders, among which the strong bureaucracy inherited from socialism stands out, were often determinant for the success of reforms.

In addition, very relevant for this study is a discussion about the influence of democratic institutions on the capacity to carry out unpopular and painful reforms, which were necessary to accomplish the transition from plan to market and from authoritarianism to democracy. Existing research debates at length the virtues and drawbacks of unconstrained executives on the one hand and a net of checks and balances on the other.

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The following section analyses the points raised above by presenting a review of the literature on the political economy of pension reforms in the region. It summarises the policy legacies (pension system characteristics, crises and responses) and their impact on the role of policy innovations, popular demands and policymakers' strategies. A brief excursus on political-institutional structures precedes the introduction of the four case studies.

Policy legacies: crisis and reform of the post-socialist welfare state

In order to understand why Central, Eastern and Southeastern European countries tried *en masse* to structurally overhaul their pensions, some fundamental features of inherited retirement schemes have to be briefly introduced. The erosion of socialist PAYG systems started long before the transformation of central planning or self-management into a market economy. These schemes were initially sound, however subsequent amendments rendered them obscure, financially unsustainable and illegitimate in the eyes of the public (see e.g. Ringold, 1999).

The retirement age was low and pensions rather undifferentiated. Notwithstanding the flat distribution of income, employees were granted earnings-related benefits, calculated according to best- or last-years formulae. Insurance was neither universal, as it depended on the existing employment relationship and was mainly aimed at the industrial labour force (only later was coverage expanded to farmers and self-employed),[6] nor egalitarian, as privileges were granted to those holding risky and unhealthy occupations (in Poland alone, 250 different categories of workers enjoyed early retirement rights). In addition, these systems were used to cross-subsidise other budget expenditure items, e.g. social assistance, and slowly started to generate increasing deficits.[7]

If late socialism slowly wore down the schemes, the transformational recessions triggered their collapse. The scheme's performance on Weaver's (2004: 76) dimensions of crisis (demographic, labour market and fiscal) sharply deteriorated.

The transformational recession created in some countries a proper demographic emergency: not only have most countries in the region developed prospects as dramatic as those of Italy or Japan, but they also, on average, age faster (Chawla, Betcherman, and Banerji, 2007). During early transition, in order to put some pressure off overstrained labour markets and improvise a social safety net, older unemployed or redundant workers were forced to retire. The

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[6] Retirement was a *de facto* extension of the constitutionally guaranteed right to work and was therefore Bismarckian in nature (cf. Wagener, 2002: 154).

[7] It is worth noting that the Yugoslav retirement system was somehow less exposed. It followed the country's overall modernisation. It was decentralised, separated from the budget and financed by employer and employee contributions, in other words (HZMO, 2002: 69): *"[...] already during the 1970s, pension insurance was introduced and managed according to European standards, thereby differing from socialist Eastern European countries, which entered [...] the transition from socialism to liberal democracy and market economy with underdeveloped pension systems that functioned as parts of the public administration."*

‘great abnormal pensioner booms’ guaranteed social peace (Vanhuysse, 2006), but at the expense of budgetary thrift. At the same time, the tax administration could not cope with the multiplication of contributors, the output decline, tax evasion and informalisation of the economy. Revenues from contributions plummeted, thereby undermining the fiscal balance of public pension schemes.

After the collapse of socialism, the political exploitation of existing retirement systems continued unabated. Marginal and disorganised losers were penalised to obtain fiscal savings – for example, continuing pensions were losing purchasing power (Müller, 1999: 94-96) – and special interest groups were granted favours in exchange for electoral support (see Gomulka, 2000: 1-2). This led to the normative delegitimation of retirement schemes as performance expectations were betrayed and mutualism severed (Brooks, 2006).

Of the three reform options, refinancing soon got off the agenda, due to high social contributions in the range of 20-30%, which hindered these countries’ international competitiveness. Subsequent retrenchment, especially irregular indexation of retirement benefits (Cashu, 2003), was adamantly opposed and often declared as unconstitutional. As a consequence, fundamental restructuring became the only available option and spread around Central, Eastern and Southeastern Europe like wildfire.

Notwithstanding implicit pension debts comparable to those of OECD countries with mature PAYG systems,[8] eleven ex-socialist countries opted for a mandatory fully-funded private pillar by 2008 (Guardiancich, 2008). Such regional diffusion is surprising, given a relative consensus in the literature that transitional costs would deter many reformers (Orenstein, 2000: 10-11; Brooks and James, 2001: 148-151; Myles and Pierson, 2001: 307). Yet, Kosovo (2002) closed down its public scheme and replaced it by private arrangements, Lithuania (2004) settled for parallel privatisation, where the funded pillar co-exists as an alternative to the public system. Bulgaria (2000), Croatia (2002), Estonia (2002), Hungary (1998), Latvia (2001), Macedonia (2006), Poland (1999), Romania (2008) and Slovakia (2005) opted for a mixed system, where mandatory private arrangements complement the public pillar (see Müller, 1999: 19). All the other countries have either rejected the new paradigm (Slovenia and the Czech Republic[9]), or only partially introduced it (Serbia and Montenegro apply now a strict point system), or simply have still to embark on comprehensive reforms (Albania, the Federation of Bosnia and Herzegovina, and the Republika Srpska).

[8] Compare the results for OECD countries by Chand and Jaeger (1996) with the calculations for countries like Croatia and Poland by Holzmann, Palacios, and Zviniene (2001: 116).
[9] However, the westernmost ex-Yugoslav republic introduced a quasi-mandatory funded pillar for public employees in 2003. The Czech Republic is instead considering the introduction of an NDC formula.

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Scholars unanimously agree that the impact of socioeconomic changes cannot alone explain such scope and depth of reforms, but nor can the literature on the politics of austerity (see Weaver, 1986), which emerged as a response to the 1980s crisis of generous Western welfare states. It becomes necessary to investigate the effects of socialist legacies on the demands for policy innovation by the public and policymakers.

Politically expressed demands of social groups

Eastern pension schemes were very extensive under socialism (almost everybody had a stake in the system), so were subsequently used to shield a sizeable part of the population from the transition to a market economy. However, these systems were at the same time obscure, wasteful and discriminatory. Hence, they bread not only a pro-welfare constituency defending the status quo, but also widespread opposition, especially among the young and educated population, which demanded a fundamental restructuring of existing schemes. A short clarification is due.

As mentioned above, Pierson argued that the welfare state breeds dense networks of support, which may organise and crystallise in formidable veto points that are difficult to subdue (1994: 18):

> *"[t]here are two distinct reasons that retrenchment is generally an exercise in blame avoidance rather than 'credit claiming.' First, the costs of retrenchment are concentrated, whereas the benefits are not. Second, there is considerable evidence that voters exhibit a 'negativity bias,' remembering losses more than gains."*

Furthermore, these networks are vast as *"almost half of the electorate receive transfer or work income from the welfare state"* (Flora, 1989: 154). Hence, the 'blame-avoidance' literature maintains that imposing cutbacks is an ugly affair involving obfuscation, division and compensation tactics, which are all subterfuges to avoid the concentration of accountability in the incumbent government. In a nutshell, obfuscation is about raising the complexity of reforms, thereby rendering them *a priori* incomprehensible. Division is the exploitation of societal fault lines to gain support from a part of the electorate at the expense of the other; and compensation is the use of side-payments to appease the (most powerful) losers, who may assent to reforms once their complementary demands are acquiesced to.

As post-socialist welfare states were stretched to the limit during transition, the number of recipients of state transfers swelled enormously; see Table I.2 for the four case studies.

Table I.2 Share of the electorate receiving pension benefits

Electoral round*	Croatia 2000	Hungary 1998	Poland 1997	Slovenia 2000
Share	27.6%	38.8%	27.0%	31.0%

*Nearest election after major pension reforms. Neither pensioners' families nor state sector employees are included.

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These would verisimilarly augment the shares to well over 50%.

Given the share of society that became solely dependent on the welfare state before and during transition, it was natural to expect the emergence in post-socialist countries of a powerful, if in comparison to the West less organised, 'grey lobby' (Müller, 1999: 41). Consequently, most clumsy attempts at retrenchment in Central, Eastern and South-eastern Europe failed. Swift policy reversals, often following the intervention of constitutional tribunals and ombudsmen, characterised milder reform attempts and brutal benefit cuts alike. What worked was the much subtler irregular indexation, which however aggravated the popular dislike of public pensions.

More surprising is that, in the West as well as in the East, restructuring enjoyed much greater support than any theory on retrenchment would have ever predicted. The fact that unilateral cuts were successfully resisted in a plethora of very diverse post-socialist countries, but structural reform eagerly endorsed, means that the old system's crisis was also a crisis of legitimacy.

Bearing this in mind, Rothstein (2000) claims that the political system's main output is its own legitimation. When this legitimation ceases to subsist, a particular policy is ripe to be renegotiated. Myles and Pierson talk of the moral economy of retrenchment (2001: 321): *"Justice, fairness, and the honouring of implicit contracts between policy makers and the electorate imposes an important constraint on the possibilities for radical reform."* By contrast, if these implicit contracts are already violated, the constraints loosen. In the words of Brooks (2006: 9):

> *"The beliefs and expectations associated with a given institution thus may become a mechanism severing citizens' attachments to the status quo on the basis of perceived divergence of the institution from these established standards. These principles and expectations also may be challenged and subject to revision themselves."*

This is possibly what happened with post-socialist retirement systems. Since social assistance and social insurance were intermeshed, benefits were scant and continuously losing purchasing power, Central, Eastern and Southeastern European retirement schemes both wasted their normative legitimation and violated popular performance expectations. A 'negative consensus' provided reformers with a mandate to adopt some kind of revision to the ailing social insurance system (Brooks, 2006: 26). The surveys show that the most progressive segments of post-socialist societies, i.e. the young, educated and those above the median income, strongly supported reforms: hence, a natural generational cleavage emerged between those unable to reap the benefits of a market economy and those enjoying such prospects and privileges.

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These pro-reform constituencies favoured a renegotiation of the social contract based on increased, reinterpreted equity (fairness deriving from individual responsibility and strict reciprocity between input and output) and effectiveness (performance expectations proportional to contribution) of the new systems.

Such redefinition of underlying principles and ensuing social insurance restructuring is congruous with Natali and Rhodes' understanding of the unexpected vitality of pension reforms in Bismarckian countries. In fact, the two authors forcefully show how it is possible to introduce policy elements that may appeal to certain constituencies and trade them for less popular measures, including benefit cuts.

Policy-relevant intellectual innovations

If the demand for reforms was strong on behalf of the public, the unprecedented crisis of the Eastern welfare state left policymakers in a state of great uncertainty and in a substantial intellectual (as well as ideological) vacuum. This state of affairs intensified after simple policy corrections failed during early transition.

The appearance of the World Bank, undoubtedly the main producer of policy innovations in the field of old-age pensions during the last two decades, filled that vacuum in most of the region's countries. Its presence, as well as that of other transnational policy actors, such as USAID, marks one significant difference between the shaping of Western and post-socialist welfare states. The importance of international organisations for creating policy responses to the transitional crises is undeniable (Deacon, Hulse, and Stubbs, 1997: 91; Orenstein and Haas, 2002: 22-23). However, the nature, impact and economic soundness of this external involvement is relatively contested inside and outside academia.

With respect to external influence's nature, opinions range from enthusiastic visions of battlegrounds where *"international organizations compete to influence national social policy through loans/conditional aid, technical assistance, regulatory frameworks"* (Deacon and Stubbs, 2007: 8), to greater scepticism about policy-based conditions, which clash against the preferences of domestic policymakers and their constituencies (Mosley, Harrigan, and Toye, 1991: 68).

As for the influence of transnational policy actors on the policymaking of pension reforms, scholars advanced a number of hypotheses for their success. More or less all agree with Orenstein's (2000: 22) proposition that: "*Greater exposure to World Bank ideas and greater World Bank intervention in policy planning should therefore lead to more fundamental pension reform."* Nelson (2001: 259) posits that the existence of a blueprint in pensions was more conducive to reforms than the lack of it in health, while Müller (1999: 168-172) most strongly

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contends that high indebtedness empowered the World Bank and IMF to step in and push for pension privatisation.

In the most advanced study to date, Orenstein (2008: 95) claims that the transnational coalition headed by the World Bank employed five mechanisms to influence policymakers: the dissemination of reform ideas through conferences and seminars, the funding of reform teams during reform planning, technical assistance to reform teams, loans and technical assistance for reform implementation, career paths of reformers.

This research agrees that external influence in the area of pensions was considerable, and that the World Bank's involvement was especially crucial to put restructuring on the agenda, while perhaps reform details were beyond its reach. Two factors determined its success. First, the receptivity of domestic policymakers to policy innovations was high as a consequence of the crisis. Second, the multidimensionality and flexibility of the Bank's reform blueprint could be tailor made to the requirements of civil society and other interest groups.

The current World Bank's prescription is an upgraded version of its original three-pillar design, presented in *Averting the Old Age Crisis* (World Bank, 1994a: 15). This was updated in 2005 as a result of numerous criticisms, especially regarding the governance of private funds and the inability to cover the least protected population strata (for an evaluation of Latin American reforms, see Gill, Packard, and Yermo, 2004). The blueprint now consists of a specific five-pillar structure: (i) a basic (zero) pillar to deal explicitly with the poverty objective, (ii) a mandated, unfunded, and publicly managed defined-benefit (first) pillar, (iii) a mandated, funded, and privately managed defined-contribution (second) pillar, (iv) voluntary retirement savings (the third pillar), and (v) a nonfinancial (fourth) pillar to include the broader context of social policy, such as family support, access to health care, and housing (Holzmann and Hinz, 2005).

Notwithstanding the modifications, multipillar schemes still embody the dual paradigmatic shift from public to private provision and from collective to individual risk bearing (Chłoń-Domińczak and Mora, 2003). These suit pro-reform constituencies very well, which, as stated before, demanded significant improvements in the pension systems' equity and efficiency. At the same time, World Bank's multipillar schemes are designed to deal with the greatest problems facing post-socialist policymakers: the financial viability of public retirement systems and the economic competitiveness of the private sector. The former is here ensured via 'automatic stabilisers' implemented by actuarially stricter schemes, and the latter by the possibility to lower contribution rates in the future and the prospect of turning pension funds into key institutional investors.

Moreover, and far from being a rigid prescription, the criteria to set up such schemes were from the outset rather flexible. Reforming countries were always given a range of options

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to choose from. As a result, they tailored the multi-pillar schemes to country-specific conditions and adopted a great variety of different policy solutions. Hence, policymakers were able, as Natali and Rhodes' framework predicts, to exploit the multiple dimensions of the new pension paradigm and engage in fruitful negotiated bargains, trading the credit-claiming potential of policy innovations with cuts and rationalisation of existing public schemes.

The discussion about the political merits of an externally recommended multipillar reform does not mean that the Bank's involvement was always benign and economically sound. Despite rapid policy diffusion, the multipillar approach bred criticism both within the Bank (World Bank, 2006) and certainly outside it (Barr and Diamond, 2008; 2009).

According to Barr and Diamond (2008: 207-211), the Bank committed apparent policy mistakes such as neglecting poverty relief, implementation issues and administrative difficulties. Furthermore, the proponents of multipillar systems overemphasised its theoretical virtues and predicted excessively high replacement rates, increased coverage, manageable transition costs and higher economic growth.

Not only were part of these assumptions theoretically flawed, but many were also falsified in practice. The World Bank (2006) acknowledged most of the criticism and performed a *mea culpa*, not least by expanding and redefining its original three-pillar system design.

Political-institutional structures

As argued above, the state structures inherited from socialism and then moulded by the different extrication paths of former political elites are fundamental to determine the actor constellation for and against pension system reforms, as well as the concentration of authority in the executive.

Two aspects of policymaking are worth noting. First, although the main locus of negotiation is the corporatist arena, other actors – especially the wide array of 'elite welfare stakeholders' – were part of the pro-welfare coalition and have to be taken into consideration. Second, the reform capacity of different executives varied enormously in the region, as a result of dissimilar constitutional arrangements, which can be traced back to the extrication paths of former political elites.

Existing literature thoroughly analysed the first aspect of policymaking by mapping the actors involved in welfare state reforms and their preferences. The second aspect has instead found little space in the literature on retirement and chiefly boils down to accounts relying on veto actor theories. A brief review of the two will identify the aspects relevant for this study.

Actor constellations

In agreement with Orenstein (2000: 61), this study maintains that the depoliticisation of pension issues in post-socialist countries matched and perhaps surpassed that of Western Europe. Lacking clear programmatic alternatives, pension reforms in former socialist countries cut across all historical and social divisions. The most prominent example is Poland, where reforms were not only bipartisan but also carried through by two subsequent governments, led by opposing coalitions. Hence, both conservative and social-democratic parties were equally committed to find a solution for the region's beleaguered pension systems and both contained pro-reform liberal wings and anti-reform social and populist factions. Only small ultra-liberal parties consistently advocate fundamental pension restructuring.

What is interesting is that post-socialist countries witnessed a comparatively stronger emergence of pensioner associations and pensioner parties than the West (for a review of the possible explanations, see Hanley, 2007). These are part of the pro-welfare coalition. Frequently they are single-issue organisations whose voice is primarily heard against retrenchment measures. When structural reforms grant 'exclusionary compensation' to pensioners and older workers, who are as a consequence kept out of the new schemes and relieved of the transition costs (Brooks and James, 2001: 155-156, 159-160), the influence of these associations abates. Pensioners' power chiefly depends on their unity and access to policymaking.

Despite these partisan influences, the locus of negotiations is, in line with Natali and Rhodes' theoretical framework, chiefly concentrated in the corporatist arena. Social partners, in particular trade unions, play a prominent role in institutionalist analyses of welfare state reforms. According to Cook (2007: 13): *"Social-corporatist structures for labor bargaining strengthen the representation of pro-welfare state interests, and the political alliance prospects available to labor are key to its influence."* In Continental Europe, the consent of organised labour has been a necessary or even sufficient condition for reform, due to the union's encompassing representative role and the corporatist, co-managed nature of retirement schemes (Myles and Pierson, 2001: 322-323).

The situation in transition economies is relatively different for three reasons. First, the unions in Eastern Europe are fragmented and their membership is declining. In less than two decades, post-socialist trade unions *"lost prestige, resources and voice"* (Ost, 2009: 17). After 1989, everything that was associated with the labour movement seemed inefficient and démodé. Due to atomisation and privatisation, density collapsed, turning the unions into representatives of public employees. Firm-collected fees disappeared. Skilled staff was never employed in successor unions as former leaders left for better positions, and militant professionals quickly moved from new ones to business. Furthermore, the successors of the old federations and the

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newly founded associations still bitterly disagree on ideological as well as more practical issues, such as the inheritance of social property. This infighting hampers potential cooperation. Consequently, Orenstein (2000: 62-66) distinguishes between ‘old’ and ‘new’ trade unions that usually have diametrically opposed views on pension restructuring. The former oppose radical pension reforms due to anti-capitalist ideological reasons and institutional interest in retaining control of public schemes.

Second, although formal tripartite arrangements exist across the region and were much praised by the West, the *de facto* dependence of elites on trade unions has to be analysed on a case-by-case basis. In fact, Ost (2000) argues that post-socialist corporatism is just sand thrown into social partners’ eyes, with the significant exception of Slovenia. Token negotiations, nonbinding agreements, the exclusion of the private sector are all phenomena of low class identity and weak workers’ support. Elites are implementing tripartism to comply with EU norms and to share responsibility, thereby ?educing the acceptance of labour’s own marginalisation. Formal pacts can be overwhelmingly labelled as ‘illusory corporatism’ and are frequently substituted by less visible gentlemen’s agreements. In fact, years of degradation in workplace representation led to the desuetude of tripartite bodies.

Finally, direct access to policymaking through institutionalised ties with political parties is seen in Western literature as an effective way to promote labour-friendly policies and a generous welfare state (Huber and Stephens, 2001). In this vein, these tight links allowed Eastern trade unions to have a significant number of representatives in parliament and should have significantly increased labour’s power. Reality was, however, much less idyllic. The strong ties with political parties had very counterintuitive effects in post-socialist countries (Avdagić, 2005: 38-40). The executives used these ‘inverse dependency relationships’ to control organised labour and minimise its influence over policymaking. Political paternalism was forced onto labour unions, whose headship on the one hand sold its rank and file to political leaders by accepting neoliberal deals and on the other hand protected those identified by Cook (2007) as ‘elite welfare stakeholders’, i.e. trade union leaders, social sector administrators and the bulk of the bureaucratic apparatus.

These better-organised welfare stakeholders were never really accountable to their subordinates during communism. They held favourable positions in the welfare state and during transition they sometimes managed to infiltrate the political system and retain their privileges, especially in countries where political power was most dependent on their support. Notwithstanding that marketisation and democratisation were swiftest in Central Europe (except for Croatia), weakening the opportunities for proper state capture, bureaucratic elites had to be confronted in any reform threatening to dismantle their standing and reduce their number.

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The elite welfare stakeholders have an overwhelming interest in pension reforms for various motives. On the one hand, public employee unions have particularistic memberships that enjoy special privileges in line with the Bismarckian tradition. Hence, they often engage in policy- and vote-seeking activities by trying to obtain exclusionary compensation and transition rules to their membership.

On the other hand, and more importantly, state agencies involved with pensions (social insurance institutes and funds, tax administration, treasury, financial regulatory agencies) are not aprioristically against pension restructuring, as long as they fulfil their office-seeking objectives and retain their managing positions and staff (cf. Nelson, 2001). Although Orenstein (2000: 67) points out that the state pension administration depends mainly on political decisions, in particular through the appointments of its leadership, this under-researched aspect of pension reforms has relevance in all my cases. Where the executive was more porous to bureaucratic influence, state sector agencies managed to push for extremely inefficient policy deviations. Where, instead, their power was more constrained, at a minimum, the social insurance administration retained or expanded its staff, maintained its managerial role in public pension schemes, and was often assigned new responsibilities.

This short review of the actors involved in the politics of retirement system reforms in the region reveals there is a plurality of interests, which has to be considered by reformist policymakers. The political arena is characterised by the lack of programmatic alternatives to withstand the economic crises, and only a few parties (small ultra-liberal and pensioners) have strong views for and against reforms. Hence, the locus of negotiations in the East is the corporatist arena, albeit with greater variation in the importance and role of trade unions than in the West. What has to be particularly integrated is the preferences of 'elite welfare stakeholders', which have, among all other groups, the greatest interest in preserving a special status within the welfare state.

Institutions of government

The preferences of those shaping pension reforms, as presented in the previous section, shed light on the games played between the agenda-setter and other policy stakeholders; however, they do not tell much about the balance of power between the pro- and anti-reform camps. By focusing on the differences in domestic political institutions, the new institutionalism helps to determine the behaviour of actor constellations, clarify the mechanisms that may lead to policy change and regulate the difficulty to operate them.

The two aspects of the debates relevant to this study are: i) the different advantages and disadvantages of unconstrained decision-making versus consultation and checks and balances for

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an executive's reform capacity; ii) the consequences of the two decision-making styles on the political sustainability of policy in time.

The first argument is well developed in the literature, which is divided between two camps. The first camp extols the virtues of a 'handful of heroes' (Harberger, 1993: 343) for being the harbingers of economic reform and 'vigorous political leadership' (Sachs, 1994: 503). This became the basis for the 'unconstrained executive model', which, according to Haggard and Kaufman (1995: 7-11):

> *"[…] is important for overcoming policy stalemates. The successful initiation of reform depends on rulers who have personal control over economic decision-making, the security to recruit and back a cohesive 'reform team,' and the political authority to override bureaucratic and political opposition to policy change."*

The second camp instead argues that extensive consultation within a system of checks and balances – the so-called 'enabling constraints' (Stark and Bruszt, 1998: 166-187) – can be conducive to greater policy coherence, as opposed to the unconstrained executive model.

In general, the authors dealing specifically with the political economy of pension reforms that employ veto actor theories adhere to the former camp. The fundamental tenet of the theory (see Tsebelis, 2002) posits that, as the effective number of vetoes increases, significant policy change becomes difficult or impossible, i.e. policy adaptability decreases. In this vein, Orenstein (2000: 13) argues that: *"The fewer the number of veto and proposal actors and the lesser the distance between them, the greater the opportunity for change in the scope and size of the PAYG pension system."* Not dissimilarly, Nelson (2001: 261) compares healthcare and old-age retirement: *"[…] pension reform is 'easier' than health-sector reform. Pension systems are much less complex administratively, nor do they generate large, powerfully organized providers' associations."* Hence, both authors stress that the lower the number of veto actors, the higher the ability to adapt the policy to new socio-economic conditions.

As for the longer-term effects of the two decision-making styles, the literature seems less interested in the problem and far more nebulous. For example, Cook (2007: 18) claims that the effectiveness of the pro-reform coalition varied with the power of the executive: where this was unconstrained, as in Russia, liberalisation was non-negotiated; where it was disorganised, like in Belarus, reforms accomplished little; and where it was dispersed under democratic conditions, as in Hungary or Poland, reforms had to be negotiated. However, she does not analyse the consequences of these actions.

Orenstein (2000) is more specific. He applies veto actors and recognises a trade-off between the capacity to adapt policies to changed socio-economic circumstances and the consistency with which the policy is implemented, that is, between policy adaptability and its

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subsequent stability. The author claims (2000: 14-17) that one important aspect of successful decision-making is to recognise the existence of trade-offs across both deliberative fora and policy stages. In a nutshell, the fewer the actors involved in policy design, the swifter and more radical the reform. But there is a caveat: whereas the exclusion of a veto or proposal actor from a deliberative forum or policy stage may give the policymaker a short-term advantage in terms of time or policy orientation, this may at the same time pose greater problems in a competing forum or at a later policy stage, when the excluded actor fully activates. Conversely, the inclusion of a greater number of actors may render policies foolproof at later stages, but this may result in the delay and dilution of legislation.

Perhaps Haggard and Kaufman (2001: 18) delve deepest into this issue and give a more nuanced picture of the reform of welfare states in transition. They contend that consultation is necessary to induce compliance and manage principal-agent problems when reforms involve complex institutional and organisational change. Moreover, they claim that loss-imposing reforms require extensive consultation to bargain over the distribution of losses and generate compensatory mechanisms supportive of reforms. Brooks (2006: 19-20) broadly agrees with this approach and suggests that rewriting the underlying social contract is crucial for the normative legitimacy of, and popular expectations arising from, a reformed pension system. Otherwise, she claims, failed consultation may lead to several problems, from non-compliance to backlashes against reforms.

This dissertation espouses the view that inclusive policymaking, hence consultation and the rewriting of the underlying social contract, is the best strategy to resolve the distributive conflicts of comprehensive retirement system reform. Moreover, such a course of action induces those involved to more readily comply with the reform's prescriptions. The exclusion of one or more actors from consultation may at the same time reduce an executive's reform capacity (in the sense that distributive conflicts are not resolved and that gains and losses may be arbitrarily allocated) as well as the policy's political sustainability in time (previously excluded stakeholders are more likely to demand a renegotiation of reforms and not comply with their requirements).

Four case studies

The four cases, Croatia, Hungary, Poland and Slovenia, are a subset of a larger number of states (more than thirty by 2009) that have considered or are considering the introduction of elements of the new pension orthodoxy. Even Slovenia, which is treated by Orenstein (2008: 154-155) as one deviant case where the new paradigm was rejected, has partly privatised its pension system.

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The four countries' retirement systems developed comparable problems during transition. The number of pensioners skyrocketed, while contributors and the public administration's capacity to collect contributions collapsed. This of course generated an unbearable crisis (especially fiscal) that lasted well into the mid-1990s. Refinancing attempts swiftly clashed with the need to increase economic competitiveness and retrenchment was in most cases adamantly opposed. Such state of affairs led to major reforms in the four countries' retirement schemes at roughly the same time, between 1997 and 1999. Hence, each country has by now experienced more or less a decade of implementation.

All four countries resorted to negotiated bargains to reform the respective pension systems. Compared to earlier parametric endeavours, systemic restructuring attempts were in most cases successful. Croatian and Polish reforms are still viewed as remarkable achievements: in fact, the two countries went furthest in overhauling their pension systems. However, even where reformers obtained much less than originally planned (Slovenia) or exhausted their stamina along the way (Hungary), negotiated bargains enjoyed greater room for manoeuvre than simpler reform measures.

Although the surveys are not comparable, reforms benefited from vast support in Croatia and Poland, a plurality of those surveyed (due to low awareness) agreed to changes in Hungary and the majority of Slovenian respondents deemed restructuring necessary, while opposing the government's original plan. In all countries policymakers exploited the credit-claiming potential of funded schemes, frequently to impose significant cuts to the public pillar. Even in Slovenia, where the government rejected the original plan of a mandatory private pillar, a similar credit-claiming strategy enabled the introduction of a funded scheme for public employees in 2003. Each bargain entailed *quid pro quos*, especially in the political arena. In particular, the office- and vote-seeking aspirations of politicians (via the defence of elite welfare stakeholders) and office-seeking objectives of social partners (continued administration of social security schemes) played a significant role for the success of these political exchanges.

It is important to note, however, that negotiations were qualitatively very different from one another. Policymaking varied substantially. Croatian and Hungarian decision-makers engaged in limited, internal and often clientelistic bargaining by virtue of state structures that generate few checks and balances. Polish and Slovenian reformers were instead forced, after several failed starts, to include the majority of welfare state stakeholders in negotiations, due to the consensual nature of their decision-making processes. In all cases generosity significantly declined, but within each subgroup (the countries resorting to limited bargaining and those opting for inclusive policymaking) the deals emphasised different policy and political dimensions. In particular, Croatia and Poland bet on the financial viability of their pension

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systems and on increased economic competitiveness, while Hungary and Slovenia maintained a relatively higher degree of redistribution in their public pillars.

Most qualitative dissimilarities were not apparent from the beginning of implementation, but they started to emerge with time. The distributive consequences are very different in the four countries. On the one hand, the future fiscal sustainability of the Croatian and Polish old-age pension schemes is assured by their actuarially strict formulae. This cannot be said either for Slovenia, which will probably generate some of the highest deficits in the EU-27 in twenty years time, or for Hungary, that starts from a lower base but whose policymakers managed to reverse much of what had been achieved.[10] On the other hand, Croatia and Poland sacrificed some of the least protected social groups to maintain adequate benefit levels for their electorally valuable constituencies, putting under question the future social adequacy and hence sustainability of these scheme.

However, the most interesting and broadly neglected aspect is the importance of an inclusive policymaking process for the system's political stability, as well as continued support and compliance by stakeholders. As mentioned above, the negotiating style of Croatian and Hungarian policymakers was divisive, whereas to reform a pension system requires rewriting the underlying social contract with the aid of a majority of stakeholders. As a result their reforms proved much less resistant to changes in power and more amenable to politically driven reversals than those in Poland and Slovenia, which better withstood the test of time.

Some tentative conclusions can be drawn. None of the countries seems to have achieved a correct balance between the distributional and political consequences of pension system reforms. Among the countries that do not adequately protect their pensioners, Poland will have to introduce marginal corrections to the pension system (which it already has), and thoroughly reform its labour market. Croatia has been and will be, by virtue of limited political support, exposed to policy reversals favouring more redistribution. By contrast, Hungary and Slovenia find themselves almost in a pre-reform situation, albeit for different reasons. The future fiscal strains of insufficiently retrenched and still relatively generous Slovenian schemes render reforms urgent, but difficult due to the high popular support of the welfare state. In Hungary, instead, policy reversals during implementation and the ensuing fiscal strains were closely connected. In order to reduce the latter, further restructuring needs full political endorsement.

[10] Moreover, the Hungarian situation is marked by great uncertainty, as the new defined benefit formula enters into force only in 2013. Most experts regard it as inadequate and its revision probable.

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A roadmap to case study analysis

In order to develop the arguments above, the following chapters first present the four case studies individually and then contrast them within a comparative perspective. As in most interaction-oriented research, the unit of analysis is the reform process, comprising the legislative phase and implementation. The evaluation of the validity of the dissertation's four propositions requires both within- and across-case comparisons, which are structured as follows.

Within-case comparisons are employed to show whether the four countries' policymakers effectively relied on complex political exchanges to reform, and to dissect each of the bargains according to the policy and political dimensions proposed by Natali and Rhodes. In order to introduce the quests for systemic reforms, the effects of transition on politics and pension systems are presented. The institutions of government as well as actor constellations (electoral and party competition, the interest group configuration) are identified.[11] The crisis of each country's welfare state is analysed and early reform attempts investigated. For all relevant reforms, the policy and political trade-offs are evaluated, as well as the inclusiveness of policymaking vis-à-vis pension system stakeholders.

The analysis of the politics and policy outcomes during implementation follows. Across-case comparative data is employed to show how the trade-offs affect the future fiscal and social sustainability of these pension systems. The process tracing of a decade of implementation substantiates the proposition that the policymaking style played a significant role to guarantee the political sustainability of the newly reformed pension schemes. The sustainability dimensions are then contrasted for each case and prospects for future reforms are hypothesised.

The individual case studies and their comparison are based on the review of both primary sources (official governmental and parliamentary documents, legislative records) and secondary sources (almost 50 years in total of daily and weekly newspapers, principally the Budapest Business Journal, Delo, Finance, Rzeczpospolita and Vijesnik). In addition, the comparisons draw on more than fifty open-ended interviews with policymakers, with social policy experts from academia, social security institutions and relevant ministries, as well as with representatives of the international community.

Conclusions

For Central, Eastern and Southeastern Europe, the 'new pension orthodoxy' means the replacement of socialist PAYG systems with multipillar schemes, which entails a shift from state to market provision and from collective to individual responsibility.

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[11] These sections broadly replicate the structuring of the edited volume by Immergut, Anderson, and Schulze (2007).

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This chapter presented and built upon Natali and Rhodes' theoretical framework. It was argued that the framework well suits the analysis of the negotiated bargains that enabled such diffuse adoption of the new paradigm in the region, despite many doubts over its economic effectiveness. The actor-centred institutionalist approach was duly extended to incorporate both legislation and implementation. The policy and political trade-offs employed to reach an agreement have fiscal and social consequences way beyond legislation, while the policymaking style plays an important role for the future political sustainability of these schemes. Divisive decision-making may generate costly deviations from efficient practice and render policy reversals, as well as non-compliance by stakeholders, more likely.

The amendments to the framework reflect specific characteristics of the post-socialist context. Policy legacies heightened the seriousness of the transition-induced crises. Due to high uncertainty about the course of action, both public and policymakers were more inclined to consider innovative, often untested policy solutions. Even those recommendations by transnational policy actors that fell outside local decision-makers' social policy traditions nevertheless found fertile soil. The institutional legacies are very relevant to determine the actor constellation involved in negotiations – post-socialist countries have comparably stronger state bureaucracies and weaker civil societies – and the concentration of authority in the executive. The latter is key to determine whether policymakers resort to divisive or inclusive negotiation tactics.

The chapter concluded with a brief introduction of the four case studies. These were placed within the theoretical framework, their respective pension system reforms were concisely presented and the consequences of a decade of implementation tentatively anticipated.

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II. Croatia

Introduction

The framework employed in this dissertation qualifies semi-authoritarian Croatia as having the most unconstrained executives among those studied. Due to a political-institutional structure that neither generated extensive checks and balances, nor allocated consistent accountability onto single-party governments, Croatian executives operated almost in a vacuum during 1990-2000.

The Croatian case shall prove a number of implications. Despite the almost complete lack of scrutiny, even such unbounded authority has to follow some rule of conduct. Once simple corrective measures to rein in runaway pension spending cease to function and the system is as a result delegitimised, even an unconstrained executive cannot resort to unmitigated retrenchment. Hence, more complex measures entailing negotiated trade-offs are needed. However, it is plausible these political and policy trade-offs are not used here to build broad consensus around reforms, but rather to target narrow constituencies and push a specific reform agenda that emphasises the most pressing policymakers' objectives in terms of policy, office and vote. The flipside of such unilateral imposition is that reforms may entail discriminatory distributive consequences and be very vulnerable to even minimal shifts in the preference of those who are in power.

More than elsewhere, Croatia experienced huge shifts in political power. If pension legislation was carried out by a semi-authoritarian regime, implementation happened under completely dissimilar circumstances. Right after and partially as a consequence of reforms, post-2000 Croatia broke with the autocratic past and embarked onto a democratic course. A fundamental rethinking of existing policies, not confined to pensions, took place and entailed numerous harmful reform reversals.

Such a course of events stands in stark contrast with cases such as Poland and Slovenia, where a thick web of political checks and balances was present (almost) since the beginning of transition, and which prevented unilateralism becoming a viable policymaking option. If similarities are to be found at all, they boil down to the lack of policy alternatives due to the country's size, as in Slovenia, and to the radicalism of reforms owing to a technocratic agenda-setter, which resembles the situation in Poland. The analogies with Hungary are instead more marked. Both Croatian and Hungarian executives were completely unconstrained in the mid-1990s, albeit for different reasons. Yet Hungarian governments faced strong internal opposition that significantly influenced reforms, putting a brake on the executive's policy aspirations.

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The chapter proceeds as follows. In order to present the political-institutional environment in which legislation and subsequent policy implementation take place, the first section investigates the Croatian traumatic transition from socialism to a market economy and its negative impacts. Given an elite extrication path built upon the ethno-nationalist struggle, the institutions of government, as well as electoral or party competition, reflect the progressive drift of the Westernmost Balkan country into semi-authoritarianism. The Croatian 'lost decade' is contrasted to the following period, which is characterised by the rebirth of political and associational pluralism, during which Croatia finally embarked on a stable democratic course.

The pension system origins and crisis are analysed next. Proposition 1 states that once the possibility to enact simple corrective measures shrinks to non-existence, as during a major pension system breakdown, policymakers are forced to embark on restructuring that entails complex negotiated bargains. As the Croatian pension system is probably, among those studied in this dissertation, the one that suffered the most from transition-induced overstretching, it is shown that policymakers very soon exhausted the possibilities to refinance or retrench, and were therefore forced to find systemic solutions to the crisis.

Tracing the process of restructuring directly relates to Proposition 2, which stresses that credit-claiming elements, so favoured by the new pension orthodoxy, increase the room for manoeuvre to policymakers. These can exploit political and policy trade-offs to enact reforms that would be otherwise impossible. In order to explore how these trade-offs were employed in Croatia, the chapter traces the 1995-1999 legislative process. The public demand and technical supply for policy innovations, as well as the different interests and (lack of) alternative policy proposals, are dissected in the core section of the chapter. The Natali-Rhodes framework is built upon, as the analysis encompasses the qualitative features of negotiation. As policymakers resorted to very divisive policymaking, the question of whether these trade-offs were exploited to push the decision-makers' own agenda, instead of building broad consensus, finds a straightforward answer.

Once the institutional reform output is presented, the chapter assesses the distributional consequences and the political sustainability of the new policy arrangements. The impact of negotiated bargains on the trade-off between social adequacy and fiscal viability, as implied by Proposition 3, is analysed through the projected performance of the reformed public pillar and the role played by the small funded pillar. Given an unenviable record of gratuitous benefit cuts, it is argued that sophisticated obfuscation strategies were used to ensure the system's future fiscal viability. Additionally, the 1999-2008 post-reform experience is presented to test the veridicality of Proposition 4. The latter argues that limited bargaining allows for the allocation of uneven gains and losses, and that it does not create the incentives for continued political support of reforms. That the Croatian polity underwent such radical systemic change after the 2000 elections clearly shows that the implications of Proposition 4 are not confined solely to the pension system. The effects of this change are thoroughly described.

The transition

Most observers agree that the Croatian transition can be divided into two periods: the drift towards authoritarianism, from independence until the defeat of the Croatian Democratic Union (HDZ) in early 2000, and democratic consolidation after that. During the 1990s' 'lost decade', which is when pension reforms took place, Croatia had an autocratic and populist government, which mixed clientelism and limited pluralism. The transition's impact (the extrication strategies of elites and subsequent performance) on political-institutional structures created an environment that consistently generated unconstrained executives, which resorted to divisive policymaking. Within such a setting, characterised by the absence of partisan or other veto actors, the single-party government was able to sustain even the most discriminatory policies that unevenly allocated losses and gains. Shortly after the pension reform year, 1999, the picture changed dramatically. During the period of democratic consolidation, Croatian political and associational pluralism re-emerged and political alternation started. These gave greater voice to previously excluded actors, severely constrained the capacity of subsequent executives to act unilaterally and impaired the capacity to sustain loss-imposing policies.

Extrication and performance

Croatia was the second richest of the Yugoslav Republics, after Slovenia, and faced similar transition challenges. However, the ethno-nationalist struggle marked the involution of Croatian economics and politics.

Even though Croatia experienced at first a pacted transformation, as the League of Communists introduced multiparty politics in 1989, Serbian nationalism steered Croatia clear of this course. Exploiting the resurgence in nationalism, the conservative and populist HDZ won the founding elections by a landslide. An anti-communist single-party government replaced a communist single-party regime. The newly established ethnic-nation had its foundations in the institutionalisation of the nationalist movement, clientelistic favours and the identification of HDZ with the state apparatus. A hybrid regime that defied categorisation was created (Grubisa, 2002: 33-36; Kasapović and Zakošek, 1997: 27-29). The election of HDZ founder, former Yugoslav general Franjo Tuđman, as President of Croatia, and the successes during the Homeland War, only strengthened HDZ's position.

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Despite the Yugoslav heredity and wrong policy choices, the Croatian economy was relatively successful. Due to the war, spiralling inflation and the lack of international support, Premier Nikica Valentić launched a very rash stabilisation programme in October 1993. Hyperinflation was eliminated almost immediately, but at the same time the Valentić decrees created enormous social pain by particularly harming existing pensioners. Even though policymakers lost momentum, various structural reforms were carried out (price liberalisation, introduction of VAT, privatisation and pensions). Two macroeconomic crises were dealt with satisfactorily. However, Croatia was an international pariah because it developed systemic crony capitalism, which allowed for state capture, rent-seeking and misallocation of resources (Bićanić and Franičević, 2003: 14-23).

By offering former elites an *aut aut*, i.e. the choice between co-optation and exit, HDZ developed a policymaking style that was at the same time divisive and clientelistic. On the one hand, the party had ample leeway to unilaterally impose unpopular measures, e.g. the Valentić decrees. On the other hand, it had to continuously legitimise itself by granting favours to special interest groups. In the long run, crony capitalism doubly delegitimised HDZ: Tuđman's party betrayed public expectations through continuous recessions and it did not provide adequately secure property rights to its cronies.

The Croatian Democratic Union's electoral defeat in January 2000, a few weeks after President Tuđman's death, turned a new page in Croatian democracy, put an end to unabridged crony capitalism and mitigated (but did not eliminate) the problem of legitimation through clientelism. In September 2000, an amendment to the Constitution changed the semi-presidential system into a parliamentary one. Relations with international organisations improved immediately, Croatia started the accession process to the EU and became a NATO member in April 2009.

Domestically, alternation between the Social Democratic Party (SDP), a modern centre-left party, and a renewed pro-European HDZ, did not solve all political and economic problems. Nevertheless, after the 1998-2000 slowdown, the economy picked up and unemployment as well as inflation fell. Growth averaged almost 5% between 2001 and 2007. Due to its exposure to currency fluctuations, Croatia is in all probability not adequately prepared to withstand for the global recession that started in 2008. Notwithstanding, it appears unlikely that it may drift into another 'lost decade'.

Political-institutional structures

In addition to policymakers continuously employing divisive and clientelistic tactics, Croatian executives during the 1990s were unconstrained for three mutually reinforcing reasons:

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a semi-presidential state structure, a hegemonic party system that generated single-party governments with vast majorities, and a very weak civil society and associational potential. Hence, none of Bonoli's mitigating factors (electoral rules generating weak governments and a strong pro-welfare coalition) worked against executive unboundedness. Pro-welfare interest groups were feebler in Croatia than in the other three cases. The situation changed after 2000, when Constitutional amendments rebalanced the separation of powers in the Westernmost Balkan country: the abandonment of semi-presidentialism and the turn to a moderately pluralist party system began to generate a web of checks and balances that significantly constrains executive authority.

Institutions of government

The Croatian Christmas Constitution was promulgated on 22 December 1990. It was tailor made for Franjo Tuđman as it conferred the President disproportionate power over the government and the *Sabor*. The President had the right to appoint and relieve the Premier as well as the whole cabinet. He could convene and preside government sessions over his own agenda items. Furthermore, his presidential status was not incompatible with party-related duties.

After the election of Tuđman in May 1990, the Croatian governments under HDZ had the least constrained authority among the four case studies. The executive was irresponsive to opposition parties, corporatist actors and public opinion. Only the Constitutional Court opposed the government by, for example, demanding compensation for the 1993 Valentić decrees.

The Constitutional amendments, passed in November 2000 and June 2001, effectively transformed semi-presidential Croatia into a parliamentary democracy. The President lost his executive authority and the possibility to maintain party affiliation. In comparative terms, since 2000, Croatian executives shifted from less to more constrained than the Hungarian ones, whose structure stayed unchanged during transition. The current Croatian political configuration is presented in Table II.1.

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Table II.1 Political institutions in Croatia

Separation of power, political arenas	**Actors**	**Rules of investiture/dissolution elections**	**Rules of decision-making**
Executive	President	5-year term; directly elected; if no candidate receives 50% of votes in first ballot then second ballot is held; only one reelection; can be impeached for any violation of the Constitution.	Calls elections for the *Sabor*; calls referendums; confides the mandate to form the government to the Prime Minister; dissolves the *Sabor* after a vote of no confidence in the government.
	Prime Minister (*Predsjednik Vlade*)	Given the mandate to form the government by the President after legislative elections; is held accountable by the *Sabor* through a vote of no confidence.	Right to pass decrees, introduce and propose legislation, propose the state budget and enforce laws and other regulations enacted by the *Sabor*.
Legislative	Croatian Parliament (*Hrvatski Sabor*)[1]	4-year term, between 100 and 160 members; electoral rules vary continuously; the majority of its members dissolve the *Sabor* to call early elections; the President dissolves it after a vote of no confidence in the government.	Two readings, the third if there are significant amendments; the summary procedure consolidates the two readings.
Judiciary	Constitutional Court (*Ustavni Sud*)	8-year term, 13 judges elected by the *Sabor*; elects its President for a 4-year term.	Judicial review rights; decides on the impeachment of the President; supervises the activities of parties, elections and referenda.
Electoral	Referendum	Compulsory for the association of Croatia to alliances with other states; called by *Sabor*, by the President (at government's proposal) and 10% of voters.	Majority of votes and majority of voters.
Territorial units	20 counties (*županije*) and one city (Zagreb)	Each county's assembly (*županijska skupština*) is composed of representatives elected by popular vote, using party-list proportional representation; 4-year term.	The county assembly elects the executive county leadership; decides on the yearly budget; the county properties etc.

Source: Croatian Constitution. [1]Bicameral until 2001, when the ineffective Chamber of Counties (*Županijski Dom*) was abolished.

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Elections and parties

The nature of electoral and party competition in Croatia crucially reinforced those political-institutional features that endowed HDZ governments with unconstrained authority. During the 1990s, Croatia had a hegemonic party system, characterised by Croatian Democratic Union single-party rule. Continuously changing electoral rules and gerrymandering consolidated its power and authoritarian regression. As with other political-institutional structures, the party system underwent a major reconfiguration after President Tuđman's death. Since 2000, owing to the shift to a pure proportional electoral system, Croatia has a moderately pluralist party system, where no single party has had an absolute majority. Coalition or minority governments are the rule, impairing the capacity to unilaterally impose policies. Furthermore, a qualitative change happened within HDZ. The party shed its authoritarian tendencies and turned into a conservative pro-European party. Table II.2, Table II.3 and Table II.4 provide a summary of Croatian parties, an overview of its executives and the evolution of the electoral system.

The first period, 1990-1999, was characterised by HDZ's nationalist, anti-communist single-party rule. During the founding elections and amid souring Serbo-Croatian relations, HDZ embodied Croatian historical radicalism and stood against Serbian hegemony, appealing to both Croatians and émigrés in Herzegovina. The communist successor party simultaneously advocated democratic reforms and unsuccessfully bet on the federation's survival to attract non-Croatian votes (cf. Zakošek, 1997).

The year 1992 marked the consolidation of HDZ's hegemony. After taking credit for independence and international recognition, Tuđman was elected President and HDZ won a solid majority. Despite the implementation of the austere Valentić decrees in 1993, military success and the Dayton peace agreement pushed the country's economic troubles into the background. Tuđman called for early elections to capitalise on his sudden surge in popularity and remodelled the electoral system (Bartlett, 2003: 46-49). Due to rekindled nationalist fervour, defeat was out of the question. Even the majority of pensioners, who were most affected by the party's social policy usurpations, continued supporting HDZ (Županov, 1996: 289).

Towards the end of the decade, the Croatian Democratic Union started its rapid decline. The scandals regarding tycoons, political crises and continuous demonstrations pushed the incumbents beyond salvation. Furthermore, President Tuđman's health deteriorated and he passed away in December 1999. Finally, HDZ faced a relatively united opposition, a six-party coalition (*šestorka*) with the liberal Croatian Social Liberal Party (HSLS) and social-democratic SDP at the core, backed up by a centrist block. The *šestorka* obtained an ample majority in the *Sabor*.

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A fundamental difference between the 2000 and 1995 elections was the mobilisation of pensioners against HDZ. This reinforces Orenstein's arguments that excluded actors from one deliberative forum or phase may activate in another arena or at a later stage. In fact, pensioner demands (see page 57, below) backed by a Constitutional Court's ruling were entirely disregarded by HDZ. Their support of the centre-left opposition in 2000 was crucial, as the turnout was a whopping 76%.

The new government headed by PM Ivica Račan (SDP) marked the beginning of democratic consolidation in Croatia. The party system became moderately pluralist and the adoption of pure proportional representation ended the era of solid majorities in the *Sabor*. Since then, unconstrained executives and unilateral policymaking are just a bad memory in Croatian post-1991 history, although they were replaced with excessive party fragmentation and executive weakness.

SDP promised a thorough change in policymaking style, but the endemic nature of Croatian clientelism hindered the implementation of sound policies. Furthermore, Račan could not rein in the quarrelsome coalition, which became a minority government after HSLS quit. The five-party alliance's fragility prompted a return to power of HDZ already in 2003.

Owing to the proportional electoral system, the party's success was not clear-cut and Premier Ivo Sanader had to form a minority government, which relied on the external support of the Croatian Pensioners Party (HSU). The HSU hijacked the government by pushing it towards extreme economic populism. Nonetheless, in a couple of years, Sanader managed to change HDZ from closed, aggressive and nationalist into a pro-European conservative party at ease in a liberal democracy (Fisher, 2006: 195-196). The metamorphosis resulted in the party's renewed success during the November 2007 elections.

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Table II.2 Party system in Croatia (after 2007 elections)

Party family affiliation	Acronym	Party name	Ideological orientation	Establishment and merger details	Foundation
Right	HDZ	Croatian Democratic Union (*Hrvatska demokratska zajednica*)	Christian democratic		1989
	HSP	Croatian Party of Rights (*Hrvatska stranka prava*)	Radical nationalist	Oldest Croatian party.	1861, banned 1929, re-established 1990
Centre	HNS	Croatian People's Party – Liberal Democrats (*Hrvatska narodna stranka - liberalni demokrati*)	Civic liberal	The Croatian People's Party merged with Libra, a liberal party, in 2005.	1990
	HSLS	Croatian Social Liberal Party (*Hrvatska socijalno liberalna stranka*)	Social liberal	HSLS merged with the Lberal Party (LS – *Liberalna stranka*) in 2006.	1989
	HSS	Croatian Peasant Party (*Hrvatska seljačka stranka*)	Agrarian populist	During socialism it operated in exile.	1904, banned 1941, re-established 1989
Left	SDP	Social Democratic Party of Croatia (*Socijaldemokratska partija Hrvatske*)	Social democratic	Successor of the League of Croatian Communists, it merged with the Croatian Social Democrats (SDH - Socijaldemokrati Hrvatske) in 1994.	1990
Regional	HDSSB	Croatian Democratic Alliance of Slavonia and Baranja (*Hrvatski demokratski savez Slavonije i Baranje*)	Regional – Slavonia and Baranja		2006
	IDS-DDI	Istrian Democratic Assembly (*Istarski demokratski sabor*)	Regional – Istria		1990
Nationality	SDA Hrvatske	Party of Democratic Action of Croatia (*Stranka demokratske akcije Hrvatske*)	Bosnian minority	Current name since 1992.	1990
	SSDS	Independent Democratic Serbian Party (*Samostalna demokratska srpska stranka*)	Serbian minority	The Independent Serbian Party (Samostalna srpska stranka) renamed into SSDS in 1997.	1995
Pensioners	HSU	Croatian Pensioners Party (*Hrvatska stranka umirovljenika*)	Single-issue party		1996

Source: Croatian Information and Documentation Referral Agency (Hidra).

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Table II.3 Croatian executives

Date of change in political configuration	Presidential election date	President (party)	Presidential majority decisive round	Election date	Start of government	Head of government (party)	Governing parties (seats)	Govt majority (% seats)	Govt electoral base (% votes)
30.05.1990				22.04.1990	30.05.1990	Stjepan Mesić (HDZ)	HDZ (205)	57.6%	40.8%
24.08.1990						Josip Manolić (HDZ)	HDZ		
17.07.1991						Franjo Gregurić (HDZ)	HDZ		
	02.08.1992	Franjo Tuđman (HDZ)	56.7%						
12.08.1992				02.08.1992	12.08.1992	Hrvoje Šarinić (HDZ)	HDZ (85)	61.6%	44.7%
03.04.1993					03.04.1993	Nikica Valentić (HDZ)	HDZ		
07.11.1995				29.10.1995	07.11.1995	Zlatko Mateša (HDZ)	HDZ (75)	59.0%	45.2%
	15.06.1997	Franjo Tuđman (HDZ)	61.4%						
27.01.2000				03.01.2000	27.01.2000	Ivica Račan I (SDP)	SDP (43), HSLS (25), HSS (17), IDS (4), HNS (2), LS (2), others (3)	63.6%	56.4%
	24.01.2000	Stjepan Mesić, (HNS, HSS, LS, IDS, ASH)	56.0%						
30.07.2002						Ivica Račan II (SDP)	SDP (43), HSS (17), HNS (2), LS (2), others (3) – minority govt	44.4%	NA
23.12.2003				23.11.2003	23.12.2003	Ivo Sanader I (HDZ)	HDZ (66) – minority govt HSU (3), others (8) – external support HSP (8) – external support after 2005	43.4%	33.2%
	02.02.2005	Stjepan Mesić, (SDP, HNS, HSS, IDS, Libra, LS, PGS, SDA Hrvatske)	65.9%						
12.01.2008				25.11.2007	12.01.2008	Ivo Sanader II (HDZ)	HDZ (66), HSS (6), HSLS (2), SDSS (3) HSU (1) – external support	50.3%	42.0%

Source: Croatian Information and Documentation Referral Agency (Hidra).

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Table II.4 Electoral systems in Croatia (*Sabor*)

Year	Seats	Method for allocating seats
1992	138 of which 60 proportional 60 majoritarian 13 proportional for Serbians 4-5 majoritarian for minorities	Single-ballot mixed system (voters cast two votes): - PR in individual electoral districts with 3% threshold and d'Hondt conversion method - relative majority of votes in single-seat districts - PR - relative majority of voters in single-seat districts for minorities
1995	127 of which 80 proportional 28 majoritarian 12 proportional for expatriates 4 majoritarian for minorities 3 unconstrained for Serbians	Single-ballot mixed system (voters cast two votes): - PR in individual electoral districts with 5% threshold for parties, 8% for two-party coalitions, 11% for three or more and d'Hondt conversion method - PR in the electoral district for expatriates - relative majority of voters in single-seat districts for minorities - unconstrained vote (voters cast three votes) in the electoral district for Serbians
2000	151 of which 140 proportional variable quota, proportional for expatriates 5 majoritarian for minorities	Single-ballot PR system: - PR in 10 electoral districts (14 seats each) with 5% threshold and d'Hondt conversion method - PR in the electoral district for expatriates - relative majority of voters in single-seat districts for minorities
2003	152 of which 140 proportional variable quota (maximum 14), proportional for expatriates 5 majoritarian for minorities 3 unconstrained for Serbians	Single-ballot PR system: - PR in 10 electoral districts (14 seats each) with 5% threshold and d'Hondt conversion method - PR in the electoral district for expatriates - relative majority of voters in single-seat districts for minorities - unconstrained vote (voters cast three votes) in the electoral district (3 seats) for Serbians
2007	153	Unchanged

Source: Izborna enciklopedija (www.izbori.hr).

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Interest groups

In addition to political-institutional structures that fostered the concentration of authority and a structure of electoral competition that generated single-party governments, during the 1990s Croatian civil society closely resembled an associational wasteland, where only elite welfare stakeholders (the strong state bureaucracy and narrow interest groups, such as the Homeland War combatants) exerted an influence on policymaking. The pro-welfare coalition, and especially the labour movement, whose agreement in Bismarckian countries represents a sufficient condition for pension restructuring, was missing in Croatia. This further freed the hands of the executives, which did not feel obliged to consult excessively feeble social partners and other undesired interest groups. After the end of HDZ's decade in power and in line with changes to political institutions, civil society revitalised. This rebirth increased its ability to act collectively and resist executive measures that arbitrarily allocate gains and losses. Given the concomitant weakening of executive power, compromised solutions now seem the only option for passing complex socioeconomic legislation.

Although labour legislation sets high standards of industrial relations, major problems determined the weakness of trade unions during the 1990s: fragmentation and quarrelsomeness, negative structural features and underdeveloped social dialogue.

During 1945-1990, only one umbrella organisation, the Croatian Trade Union Federation (SSSH), operated in Croatia and was divided in 20 unions. The pluralisation of trade unions resulted in extreme fragmentation, owing to a 1996 Labour Code that permits the establishment of a trade union with just ten members and an association with just two unions (Wannöffel, Le, and Kramer, 2007: 16-17). The requirements for representation in tripartite bodies are higher: 15 thousand members, five trade unions at national level and operations in 11 counties. By 2008, five representative associations fulfilled the criteria, as shown in Table II.5.

Table II.5 Trade unions and membership (2004 and latest)

Union of Autonomous Trade Unions of Croatia (*Savez Samostalnih Sindikata Hrvatske*)	SSSH	211,205
Independent Croatian Unions (*Nezavisni Hrvatski Sindikati*)	NHS	87,313
Croatian Trade Union Associations (*Hrvatska Udruga Sindikata*)	HUS	53,000
Association of Workers' Trade Unions of Croatia (*Udruga Radničkih Sinidikata Hrvatske*)	URSH	50,000
Association of Croatian Public Service Unions (*Matica sindikata javnih poduzeća*)	MATICA	49,875

Source: European Commission (2008a: 119).

High unemployment, the informalisation of the economy, flexible work arrangements and a precarious financial situation are responsible for density decline, membership defection,

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understaffing and low bargaining power of the Croatian labour movement. As for tripartitism before 2000, the predecessor of the Economic and Social Council (ESV - *Ekonomsko Socijalno Vijeće*) was inconsistently managed and displayed uneven results. It issued non-binding opinions and had little credibility with the public and social partners.

Enjoying such low authority, social partners had very little say on socioeconomic issues and were altogether disregarded by the Croatian Democratic Union. Frequently, the labour movement faced HDZ executives that avoided responsibility and consultation, did not enter real negotiations and presented already drafted laws. The party even diminished the union's representation across the boards in various state institutions, including that of the Croatian Pension Insurance Institute (HZMO). During the 1990s, the executive's divisive and unilateral decision-making was the main driver of reforms, leaving very little legitimacy for social dialogue (cf. Lowther and Sever, 2006).

As for other political-institutional features, after 2000 the Croatian labour movement witnessed two encouraging developments: the timid resurgence of social dialogue within the ESV and greater awareness of the need to act collectively. As much as pensioners did in the electoral arena, the previously sidelined labour movement reorganised and mobilised against a number of HDZ policies. Hence, after not comprehending the importance of pension reforms during the 1990s, the 2007 slogan of the International Workers' Day was (Vjesnik, 2 May 2007): *"We request the reform of the pension reform – we do not bow to poverty in old age"*.

Pensioner associations experienced a similar fate as the trade unions. Until the emergence of the Croatian Pensioner Party (HSU), retirees were barely organised. Their associations played a marginal role and were plagued by incompetent leadership and lack of coordination. Despite their potential for single-issue voting, a major political threat in the rest of Central, Eastern and Southeastern Europe, pensioners failed to react. Following the Valentić decrees, no one capitalised on the pensioners' sacrifice to finance the defence of the country (see Vjesnik, 29 November 2003). The only worthy collective action was the appeal by pensioner associations to the Constitutional Court, right after the stabilisation package slashed pension benefits.

Failure by HDZ to satisfactorily deal with the Court's decision rekindled the movement. Before the 2000 vote, pensioners deeply resented HDZ's conduct. The preference for the centre-left coalition was univocal: pensioner associations supported the *šestorka* through two agreements - the Agreement for an equitable Croatia signed by the union SSSH and the Social agreement (Vjesnik, 6 December 1999, 10 December 1999). When inquired about the reasons for not supporting HDZ, the associations answered that HDZ's main candidate was former Pemier Nikica Valentić, who devised the 1993 stabilisation package and was responsible for the deteriorating social position of pensioners. After 2000 pensioner associations, by virtue of

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HSU's pivotal role, managed to exert great influence on subsequent Croatian governments, which fulfilled most of their demands.

In contrast to the above, two groups had rather strong influence over HDZ executives during the Croatian drift into semi-authoritarianism. First, the state bureaucracy was a direct emanation of the party and had to be bought off through very high side-payments. Second, Homeland War combatants were a favoured narrow constituency of the Croatian Democratic Union. They were represented by almost thirty organisations and managed to secure their own Ministry. The concessions to this group still heavily burden on Croatian finances.

Pensions

Before the start of transition, the consolidation of self-management and decentralisation in Yugoslavia deeply affected Croatian pensions via the 1982 federal Pension and Disability Insurance Fundamental Rights Act. Croatian retirement was organised into three self-managed communities of interest, which became Republican Funds, following the amendments to the Croatian Constitution in 1990 (HZMO, 2002: 64-74). The Croatian Workers' Pension and Disability Insurance Fund (RFMO) comprised around 90% of the insured and beneficiaries. The three funds merged in 1999 into the Croatian Pension Insurance Institute (HZMO).

As with the other pension systems in ex Yugoslavia, the Croatian one followed continental Bismarckian models, at least in that it was financed by employer and employee contributions. After independence, the Croatian budget assumed responsibility for previous federal obligations, newly established merit pensions (see Table II.11) and growing deficits.

The transition had a detrimental impact on Croatian pensions. The Homeland War and the transformational recession precipitated the situation. In line with Proposition 1, which states that systemic reforms result from the impossibility to enact simpler corrective measures, Croatian policymakers in vain attempted to refinance and retrench the system, until a serious discussion on restructuring started in November 1995.

Crisis

During the first years of transition, the Croatian pension system inherited excessively permissive eligibility criteria, which were further relaxed to build a social safety net. The system was repeatedly abused to grant favours to clienteles and was simultaneously squeezed to cut public spending. Thus, the Workers' Fund witnessed a massive increase in beneficiaries and a steep decline in contributors.

Pension expenditures and budget transfers swelled but were impossible to finance, resulting in the collapse in average replacement rates. Table II.6 provides a summary of the crisis.

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Table II.6 Croatian pension crisis characteristics

	Pension expenditure /GDP	Pension revenues /GDP	Pension balance /GDP	Number of pensioners	Number of insured	Contribution rate	Replacement rate
Effect	**Collapsed in 1990-1992 from 11.3% to 7.7% of GDP, then almost doubled until 2001, reaching 13.9% of GDP.**	**Plummeted in 1994-2001. The share covered by contributions fell from 96.6% to 57.6%.**	**Roughly stable, but budget transfers skyrocketed from 0.0% to 5.7% of GDP in 1994-2001.**	**Increased by 55.3% during 1990-1999.**	**Fell by 29.9% in ten years.**	**Rose until 1994 and declined since.**	**Fell from 75% to 45% of average wages, stable since 1995.**
Cause	Worsening SDR and the unstoppable inflow of privileged pensions.	Erosion of the base, arrears, exemptions and lower contribution rates.	Deficits appeared after 1998. Regular transfers and pensioner debt constitute the bulk of budget commitment.	High unemployment (it almost tripled) and high share of merit pensions.	Informalisation of the economy and widespread purchase of service years.	From 18.5% in 1991 to 27% in 1994. Declined to 21.5% before reforms in 1998.	Two collapses: 1990-1991 (break-up of Yugoslavia), 1993-1995 (Valentić decrees).

Table II.7 shows the spectacular deterioration of the System Dependency Ratio, which soon got far out of line with the Croatian age structure (cf. World Bank, 1997: 78). As unemployment nearly tripled during the 1990s (from 7.2% to 21.1%), the pension system was used as a buffer for redundant workers, the displaced, and to award merit pensions.

The deterioration had multiple origins. Low retirement age – 60 for men and 55 for women after 20 years insurance and a full pension qualifying period of 40 and 35 years respecitvely – was coupled with insufficient penalties for early retirement. The already low temporary decrement was reduced in 1989 for those who were laid off as a consequence of bankruptcy or liquidation (HZMO, 2002: 65). Generous buyouts of missing insurance periods were allowed since June 1990 (Narodne Novine, 25/90). Employers used them as a substitute to labour market adjustments until the new Labour Code discontinued the scheme (Narodne Novine, 38/95). Some 100 thousand workers, representing 20-25% of jobs lost during transition, purchased roughly 175 thousand years of service (Andrijašević, Kovačević, and Sabolović, 1997: 241). Merit, disability and survivor pensions swelled as a consequence of the war. Decentralised and unsupervised assessment of Homeland War combatant and disability statuses allowed for a higher-than-expected inflow of new pensioners, especially after the 1995 truce (Puljiz, interview).

The increase in pensioners triggered an explosion in expenditures. Widespread corruption, barriers to entry, and high contribution rates triggered two phenomena: the informalisation of the economy and massive evasion of contributions (Bejaković, 2002: 335-338). War veterans, the police and army were granted exemptions without reductions in entitlements. Self-employed and farmers registered lower compliance rates also due to the failure

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in adjusting their minimum taxable incomes to nominal wages (Anušić, O'Keefe, and Madžarević-Šujster, 2003: 19). Waivers on contributions supported shipyard rehabilitation.

Another source of evasion was a messy data collection system. Multiple agencies with overlapping functions, overstretched audit and asynchrony between monthly contribution and yearly data collection, led to protracted delays in monitoring, and lay at the core of state-owned enterprises choosing not to contribute (or even forge) data, because they stood little chance of being persecuted (Bejaković, 2004: 69-70). Hence, revenues plummeted. Budget transfers increased from zero in 1994 to almost 6% after 2000.

The situation became swiftly unsustainable and triggered multiple, mostly inadequate, reactions in terms of refinancing and retrenchment.

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Table II.7 Economic and pension system indicators

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
HZMO outlays as % of GDP	10.83	7.71	8.51	9.70	10.84	11.43	12.48	12.02	13.45	13.26	13.87	13.09	12.44	12.1	11.80	11.54	11.09
Pension outlays as % of GDP	10.1	7.3	7.3	7.2	8.5	9.2	10.62	11.29	12.92	12.77	13.45	12.74	12.15	11.82	11.54	11.28	10.86
Insured to pensioners	2.56	2.23	2.14	1.97	1.81	1.66	1.59	1.54	1.38	1.36	1.36	1.36	1.37	1.37	1.39	1.40	1.41
Pensioners to insured	0.39	0.45	0.47	0.51	0.55	0.60	0.63	0.65	0.72	0.74	0.74	0.74	0.73	0.73	0.72	0.71	0.71
Age Dependency Ratio (+65/15-64)	17.2	17.8	18.4	19.0	19.6	20.3	21.0	21.6	22.3	23.0	23.7	24.3	24.9	25.3	25.6	25.7	-
Net replacement rate	62.8	63.2	61.8	52.5	45.9	45.9	47.0	46.3	38.4	37.6	41.4	40.7	40.0	42.1	41.8	40.5	40.0
Insured (thousands)	1,839	1,725	1,698	1,622	1,568	1,479	1,469	1,472	1,406	1,381	1,402	1,422	1,444	1,460	1,499	1,538	1,579
o/w in 2nd pillar												938	1,063	1,164	1,249	1,322	1,396
Beneficiaries	656	720	775	795	825	866	889	926	955	1,018	1,019	1,032	1,042	1,055	1,066	1,081	1,100
o/w old age	353	400	419	440	443	458	478	495	518	532	540	545	554	558	564	573	578
o/w disability	183	183	182	186	190	191	198	201	235	237	238	237	236	238	235	237	240
o/w survivors	184	193	193	191	191	192	199	206	210	213	217	219	224	227	231	234	235
Unemployment	13.2	13.2	14.8	14.5	14.5	10.0	9.9	11.4	13.5	15.7	16.4	14.5	14.4	13.8	12.3	10.5	9.7
GDP growth	-21.1	-11.7	-8.0	5.9	6.8	5.9	6.8	2.5	-0.9	2.9	4.4	5.6	5.3	4.3	4.3	4.8	5.6
Inflation	123.0	665.5	1,517.5	97.6	2.0	3.5	3.6	5.7	4.0	4.6	3.8	1.7	1.8	2.1	3.3	3.2	2.9
Wage growth	-	-	-	-	34.0	12.3	13.1	12.6	10.2	7.0	3.9	6.0	4.8	6.4	4.4	6.2	6.2
Budget balance	-	-4.2	-0.9	0.6	-0.7	-0.4	-1.3	-3.5	-8.2	-7.5	-6.8	-4.9	-6.2	-4.8	-4.0	-3.0	-2.3
Public expenditure	-	38.9	37.3	25.3	48.9	45.3	44.4	54.6	56.6	52.7	50.7	50.7	51.3	49.5	48.5	47.8	48.3
Public debt	-	-	-	22.0	19.3	29.2	32.4	37.6	46.4	39.7	40.1	40.0	40.9	43.2	43.7	40.8	37.8
C/A balance	-3.8	3.4	5.9	4.7	-7.6	-5.0	-12.6	-6.8	-7.7	-2.8	-3.7	-8.6	-7.2	-5.0	-6.3	-7.9	-8.6
External debt	17.9	28.8	25.8	20.5	20.2	26.7	37.1	49.7	54.5	61.5	61.5	61.9	75.8	80.0	82.4	85.6	87.8

Source: HZMO and Crostat. ADR: HNPStats (World Bank). Economic indicators: European Bank for Reconstruction and Development (EBRD) (http://www.ebrd.com/country/sector/econo/stats/sei.xls).

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Early responses

Refinancing consisted of two moves: contribution rates were progressively increased (see Table II.8) and some 15% of total privatisation assets were assigned to the Workers' Fund in 1992.

Table II.8 Changes in contribution rates

Period	1990[1]	1991	23.4.1991 – 1993	1994	1995 - 1997[2]	1.2.1998 - 31.5.2000	1.6.2000 - 2002	2003 - onwards
Employees	16.70	9.50	11.00	13.50	12.75	10.75	10.75	20.00
Employers	7.40	9.00	11.00	13.50	12.75	10.75	8.75	0.00
Total	24.10	18.50	22.00	27.00	25.50	21.50	19.50	20.00

Source: HZMO (2002: 93) and Narodne Novine (01/05). [1]These still refer to personal and work organisations' income. Payroll contributions were introduced in 1991. [2]5.5% was diverted to the Croatian Health Insurance Institute (HZZO) to finance health care for the elderly.

The Socially-owned enterprises transformation act (Narodne Novine, 19/91) required that most Croatian enterprises convert into joint-stock companies and prepare a privatisation plan. Unsold shares were offered to institutional investors. In order to trade with these assets, the Funds established in April 1992 the joint-stock company Croatian Pension Insurance (HZMO, 2002: 81-82).

The initial hopes were that these assets produce enough returns to resume full indexation. However, the World Bank (1997: 82-83) maintained that this expectation was unrealistic at best. As a matter of fact, the importance of privatisation for Croatian pensions remained marginal. Furthermore, the scandals surrounding its management considerably undermined public confidence and consolidated the belief that HDZ stripped pensioners of their belongings through scam privatisation (Bejaković, interview).

Soon both refinancing measures proved fruitless. In 1993, the crisis was at its height: the conflict with neighbouring Serbia harmed the Croatian economy and halted the international community's support. Foreign capital inflows froze and the tourist industry ceased to operate. The country drifted into hyperinflation. As a result, Premier Nikica Valentić unilaterally launched a stabilisation programme, which, amongst other things, radically curtailed pension entitlements.

The stabilisation plan entailed a short-run inflation reduction, through a fiscal and monetary squeeze, followed by structural reforms to maintain a low inflationary equilibrium (pension reform was part of longer-term plans). The first stage functioned magnificently: by November inflation fell to less than 2% (Valentić, 1997). However, the means to achieve this had a harsh social impact.

Ad hoc benefit indexation started with a strict limitation of available resources devoted to pensions and wages. In order to curb hyperinflation, the amounts allocated for pension benefits

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had no connection to price, wage or GDP growth (Narodne Novine, 91/94, 93/93). Subsequent decrees, lasting until December 1996, consolidated this trend.

Merit (tax-financed) pensions were not refinanced and, at least until mid-1996, the government tolerated contribution evasion, which led to major delays in ordinary payments and further diminished the available resources (Županov, 1996: 286-287). Revenues experienced a 15-20% shortfall. Consequently, the Workers' Fund had to improvise internal regulations to calculate benefits. Data on wages was forged in order to keep valorisation at the level sufficient to pay out pensions, meaning that the old benefit calculation formula with generous yearly accrual rates was discontinued (Anušić, interview).

HDZ unevenly distributed the economic burden of stabilisation. Limiting the growth of wages would have had a more balanced effect. Instead both pensions and wages were blocked, and subsequently only wages were allowed to grow freely. The divergence between the two emerged only much later, thereby shielding HDZ from blame (Mintas Hodak, interview). The result was a drastic drop in replacement rates, as shown in Table II.7.

Reaction

The cuts imposed by Valentić triggered the reaction of pensioner associations, which immediately challenged the decrees in front of the Constitutional Court. Even though the Court dragged its feet for years, the Croatian Democratic Union understood that, alongside refinancing, further cuts would be impossible to introduce. The impossibility to enact simple corrective measures, as envisaged in Proposition 1, convinced policymakers to seriously consider restructuring.

In order to mitigate growing unease, the same Valentić government authorised in May 1995 a symbolic individual supplement (Narodne Novine, 33/95) and the following, Zlatko Mateša's government put an end to the customary rule by decree (Narodne Novine, 20/97). The 1997 Act on the indexation of pensions introduced partial compensation for insufficient benefit growth during 1995-1996. Regular indexation resumed in January 1997. Transfers for merit pensions were restored. However, neither the public scheme's fiscal position nor pensioners' deteriorating situation improved.

Moreover, the 1997 Act discontinued all preceding indexation-limiting decrees. Consequently, the Constitutional Court interrupted the plaintiff initiated by pensioner associations in 1993 on grounds that the abovementioned decrees ceased to have effect (Narodne Novine, 48/97). This resolution turned the public against the Court and rekindled pensioner associations' efforts. Together with the Croatian Pensioner Party, they challenged the constitutionality of the 1997 Act on the indexation of pensions.

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The Constitutional Court felt the pressure and found itself in a struggle with the executive over the division of powers in Croatia. Hence, its decision of 12 May 1998 (Narodne Novine, 69/98) ruled that a series of temporary measures, contained in the Valentić decrees, cannot simply become permanent. The initial unfavourable financial conjuncture in Croatia shall not cause losses to current pensioners and preclude compensation for prior damage. The decision established the so-called 'pensioner debt' to compensate for intentional *ad hoc* indexation and inadequate valorisation, both stemming from the transfer of insufficient resources to the Workers' Fund between November 1993 and December 1998 (Anušić, O'Keefe, and Madžarević-Šujster, 2003: 33-34; Bejaković, 2006).

This victory again failed to produce immediate results for pensioners. The government led by PM Zlatko Mateša continued to dismiss the deriving obligations, thereby only confirming HDZ's disregard for the rule of law. Nevertheless, lawyers argued that a judicial decision could not be ignored. Finally, Mateša acknowledged that Croatian governments during 1990-97 did not fulfil their budgetary commitments towards the three HZMO predecessors.

During the very parliamentary session when the Pension Insurance Act was finally legislated, the *Sabor* passed the 'Small pension law' (Narodne Novine, 102/98). This allocated circa 1% of GDP *per annum*, to be disbursed during the period 1998-2002, to compensate for missing budget transfers and to cover state obligations for insolvent enterprises. In reality, the *Sabor* messed up the allocation of this amount. Instead of a logical proportional distribution to all beneficiaries, MP Đjuro Njavro (HDZ) put forward a more redistributive formula (Njavro's supplement).

Nonetheless, pensioner associations were not satisfied and, as it will be shown below, the disregard for the Court's ruling elicited harsh electoral retribution.

Restructuring

Compatibly with Proposition 1, after refinancing met its limits in excessively high contribution rates and retrenchment hit hard the living standards of pensioners, triggering the Constitutional Court's reaction, more audacious restructuring was discussed. The introduction of credit-claiming elements, such as a mandatory funded pillar, was strongly advocated by the World Bank and much welcomed by public opinion. Indisputably, and in line with Proposition 2, restructuring opened up greater room for manoeuvre to decision-makers, who were stuck in an unyielding paralysis. Given the divisive and clientelistic policymaking practices of HDZ, whose executive at the time was completely unconstrained, the policy and political trade-offs were not used to build broad consensus around reforms. The Plenipotentiary obfuscated radical retrenchment and, at the same time, nurtured the party's elite welfare stakeholders.

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The restructuring process was tormented by continuous delays. The five-year gap between the Valentić's decrees and final legislation was a consequence of the raging Homeland War, which demanded large budget transfers. In addition, after taming hyperinflation, the package's long-term stages were discontinued and pensions slipped off the agenda.

The November 1995 international conference in Opatija, organised by the Croatian government, the East-West Institute and the World Bank, represented the conceptual turning point (Müller, 2003: 96-97). During the conference, freshly appointed Premier Zlatko Mateša endorsed the multi-pillar concept and devised an optimistic reform schedule: legislation in 1996 and implementation during 1997. The new parameters, which aimed to restrict eligibility and create a base for second pillar contributions, were to be in place by mid-1997.

Notwithstanding the inclusion of the costs for the transition to a second pillar in the 1997 draft budget, other fiscal priorities indeterminately suspended reforms (Anušić, O'Keefe, and Madžarević-Šujster, 2003: 23-24). Scarce budgetary resources were dished out to secure Tuđman's triumph in the June 1997 presidential election, while postponements to the introduction of VAT prevented Finance Minister Borislav Škegro from having a secure revenue base to cover transition costs (Mintas Hodak, interview).

To streamline the legislative process, the government established a Plenipotentiary for pension reform in February 1998 (Narodne Novine, 27/98). Due to the beneficial impact of VAT on 1998 revenues, reforms continued with renewed determination. The Plenipotentiary was independent, a firm condition imposed by Zoran Anušić, a former advisor of PM Mateša. He was seconded from the World Bank and helped maintain informal Bank-government relations during difficult times (cf. World Bank, 2004: iii-iv).

Despite its autonomy, the Plenipotentiary did not depoliticise the issue, and this probably led to suboptimal policy solutions. If the Bretton Woods' institution is to blame for pushing a multipillar design in the absence of sound economic and institutional preconditions (cf. World Bank, 2006), it was the domestic actors who interpreted the Bank's recommendations to suit their narrow political interests.

The Plenipotentiary's coordinator was Deputy PM Ljerka Mintas Hodak and its Board was basically the premier's narrow cabinet. The legal and economic working groups had their tasks divided. The economic one had to prepare draft legislation on the second and third pillars; the legal one all accompanying legislation. Together they were in charge of the final phases of the Pension Insurance Act, of the public information campaign and of implementation.

After the creation of the Plenipotentiary, the adoption of legislation proceeded swiftly. Minor delays resulted from external events (e.g. the 1998 Constitutional Court decision) and careful sequencing. The Pension Insurance Act was adopted in July 1998, entered into force in

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January 1999 and opened the door for second pillar legislation. Bearing in mind the Polish experience (the failed adoption of a law regulating annuities), Croatian MPs requested a draft law regulating annuities before passing the Funds Act. This determined a first postponement of contribution diversion to private funds. Later setbacks were chiefly connected to the 1998-99 banking crisis and the electoral victory of SDP and HSLS.

Politically motivated reappointments of personnel took over a year's time. The old Plenipotentiary was disbanded in 1999 and a new one formed in early 2000, chaired by Deputy PM Željka Antunović (SDP), whose task was to evaluate the recent laws. By retaining World Bank official Zoran Anušić and other key actors, continuity was ensured. The fact that the Social Democratic Party opposed the reform in the *Sabor* was a cause for embarrassment, and Deputy PM Antunović on various occasions claimed that changes would be introduced. However, no concrete action followed and SDP quietly accepted the acts to avoid a rupture with the World Bank (Anušić, Mintas Hodak, interview).

On the economic front, the recession and new retirement rules generated a retirement wave during 1999. Generous minimum pensions, additional obligations resulting from the 1998 'Small pension law' and the simultaneous reduction by 2% of both health care and pension insurance contributions (Narodne Novine, 54/00), renewed apprehension over the coverage of transition costs. Hence, the postponement of private fund operations until January 2002 came as no surprise.

Policy trade-offs

Of the four policy dimensions envisaged by the Natali and Rhodes framework, Croatian policymakers prioritised financial viability and economic competitiveness. Due to the difficult circumstances, World Bank's publication 'Croatia Beyond Stabilization' (1997: 78) warned against the negative microeconomic effects on labour markets and international competitiveness of high pension contributions and spending. In order to boost internal savings and strengthen the contribution-benefit link, Croatian policymakers opted for a German-inspired point system. This followed an earlier proposal autonomously developed by the Workers' Fund, which suited the continental-corporatist aspirations of Croatian scholars, who were trained within the Bismarckian tradition (see Bodiroga-Vukobrat, 1994: 334-335).

If fiscal sustainability and economic competitiveness were regarded as fundamental, the introduction of a funded element to increase these schemes' effectiveness became entrenched only following Premier Zlatko Mateša's endorsement. Croatian policymakers were chiefly

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inspired by their Chilean émigrés[12] and by the global campaign for pension privatisation. By 1995, the World Bank had been already active in Croatia and it planned a Public Sector Adjustment Loan to support the reforms of healthcare, pensions, public finance and social assistance.[13] Although the loan was never realised, pension system forecasting, legal work on funded pillars and annuities, conferences, training and consultancies were financed with the Japanese Grant attached to it.

The public appreciated the trade-off between stricter eligibility in the PAYG pillar and greater effectiveness through partial privatisation. After a major education campaign, as many as 82% of those surveyed supported reforms, especially the switch to funding (Hurd, 2003: 5).

Despite this convergence between the demand and supply for policy innovation, the transition costs attached to the funded pillar heightened the government's concern for fiscal viability. The World Bank (1997: 80-82) preferred partial, irreversible privatisation, sustained internal financing and the sale of assets owned by HZMO. 'Beyond Stabilization' envisaged a 40 cut-off age, and the creation of a semi-flat public pillar and a funded private one. Half of total contributions (10% of gross wages) was initially suggested, amounting to some 2% of GDP flowing into the private pillar *per annum*. In order to finance the transition, the Bank suggested public pillar squeezes (price indexation, formula based on lifetime earnings, actuarially fair decrements, increased retirement age) and advised against mandatory pension funds holding equity in privatised companies to avoid governance distortions. Given the tormented history of privatisation under HDZ (cf. Zdunić, 1996), a sell-off approach was preferred.

The Bank's recommendations were only partially followed. The 1999 Funds Act's main departure from the original reform draft was the substitution of the 10% contribution rate to the funded pillar with the formula *"not lower than 5%"*. Initially, the Bank's official Zoran Anušić proposed a stepwise increase, similar to Hungary, and claimed that excessive deficits should be dealt with later. Notwithstanding, the HDZ Finance Minister Borislav Škegro was irremovable and the unfortunate formula retained. Not surprisingly, *nomen est omen*, the rate stayed at 5% sharp (Anušić, Mintas Hodak, interview).

The second step to increase the system's effectiveness, i.e. the rationalisation of the revenue side of contribution collection, was given greater consideration. Collection suffered from major inefficiencies. Employers were forced to submit 20 different forms to various institutions – the Croatian Health and Pension Insurance Institutes (HZZO and HZMO), the Tax

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12 Such as former Chilean Finance Minister Hernán Büchi, who became in the early 1990s advisor to the Croatian President, and Andoniko Lukšić, a major investor in Croatia (Anušić, interview).

13 A counterbalancing role of the EU was missing in Croatia. Political conditionality precluded Croatia from participating in Phare (later CARDS for South-eastern Europe) until hostilities in Kosovo ended in 1999.

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administration – which had overlapping tasks and parallel data compilation, resulting in insufficient accountability and inefficient audit (World Bank, 2002: 3-4).

The rationalisation of revenues was for the World Bank a corollary to pension reforms. To this purpose, the 1999 Country Assistance Strategy proposed a Pension System Investment Project to strengthen administrative capacity, human resources, IT and to implement both pension and revenue-side reforms (cf. World Bank, 2004: 53). The three concurrent objectives of these measures were the centralisation of contribution collection, the consolidation of financial supervision and the creation of a single database for all Croatian public bureaus.

Apart from some concessions, the equity dimension of pension reforms was practically overlooked. Most redistributive measures were aimed at narrow clienteles, and double standards applied to ordinary pensioners and those enjoying special privileges (see following paragraph). Among measures that mitigated the strictness of the point formula were a moderately generous minimum pension guarantee and higher-than-planned indexation. Price indexation was the major concern for pensioner associations. The group was neutralised simply by agreeing to this demand. It was replaced by the 'Croatian formula', which calculates the average of wage and price growth twice a year to valorise and index.[14]

Political trade-offs

Swift legislation earned the Croatian government the accusation of having resorted to limited bargaining and imposition (Müller, 2003: 102). Being an unconstrained executive, it did not bother to consult the few and feeble proposal actors, thereby overemphasising its policy objective to reduce spending. HDZ'z only concern beyond financial viability was to increase the vote-seeking potential of the reform. This was achieved by targeting those elite welfare stakeholders that represented core conservative constituencies. By contrast, the vast political majority enjoyed by the party allowed it to disregard the social partners, not conceding them office, and at the same time bravely attempting a rationalisation of the public administration.

The divisiveness and unilateralism of Croatian policymakers is well summarised by Stubbs and Zrinščak (2007: 94-95): *"[...] opposition was weak and advocates of reform strong. In a sense, this was amplified in Croatia, as the opponents were even weaker, and reform did not become a pressing public issue"*.

Public awareness was extremely low. A survey by Puls (1999) shows that more than 80% of interviewees did not know about reforms as late as November 1999. Younger cohorts were only marginally involved in the discussion. Very few scholars objected to the government's plans. Puljiz (1999: 16), a legal expert, was particularly caustic: *"There have been quite a few*

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competent estimates that the second pensions reform has not been sufficiently well-prepared, that it is being conducted in unfavourable economic and social conditions and that, for these reasons, it will not achieve the objectives on the basis of which it has been inspired". Economists shared some of the criticisms, but most were co-opted by the Plenipotentiary. The bottom-line is that in Croatia there was no social security expert consistently supporting an antagonist position to the proponents of the new pension orthodoxy.

Public awareness rose *post factum*, after the Croatian pension institutions launched an education campaign, which focused on the functioning and promotion of the second pillar and, from November 2001, on registration procedures. USAID financed the successful operation (Hurd, 2003: 5).

Due to their inherent weaknesses, neither political parties nor social partners played a significant role in the debate on Croatian pensions. The opposition did not have an autonomous proposal, and nothing more constructive than general criticism of funding on solidarity grounds. Due to the absolute majority in the *Sabor*, the Croatian Democratic Union did not bother to consult SDP and HSLS. Ultimately, they voted against the reform.

The corporatist arena was fragmented and disarrayed. Despite some incoherent opposition against partial privatisation, not backed by any independent proposal, trade unions did not influence the reform process. This anomie resulted from interrelated problems: lack of financial means and expertise, failure to recognise the socioeconomic implications of pension reforms for workers, and insufficient political resolve for joint action (Milidrag-Šmid, interview).

The absence of initiative is testified by a rigid understanding of the pension issue as a generational competition over scarce resources. All representative labour associations overslept the Pension Insurance Act and repeatedly showed how changes in the Labour Code were their main concern (cf. Cimeša, 2003). Trade unions were criticised for their lack of commitment by the government, whereas pensioners and academics accused them of not defending the rights of future workers (Vjesnik, 11 February 2005, 30 October 2003).

The social partners retained minimal office through continued participation in the tripartite HZMO board. After 1999, the board consisted of 13 members, seven appointed by the Ministry of Labour and two each by unions, pensioner associations and employers. The government was more than overrepresented. Adding insult to injury, contribution collection was centralised and taken over by the Tax administration in July 2001. Contributions became *de*

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[14] In the 'Swiss formula', valorisation follows net wage growth and indexation a wage-price mix.

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facto part of the budget, which deprived the HZMO board, and hence trade unions, of any influence on the money financing pensions (Milidrag-Šmid, interview).

A different story concerns the endeavours by Croatian policymakers to increase their electoral potential through reforms, by granting policy favours and exceptions. Particularistic interest groups in civil society demanded the modification of various reform details (Puljiz, 1999: 14-16). The Pension Insurance Act draft envisaged an equalised minimum pensionable age of 65. Female MPs and women's associations fiercely opposed equalisation. Given HDZ's conservatism, the huge difference in life expectancy at retirement (eight years) and heterogeneous European practice, the parliamentary debate settled on retirement at 65 for men and 60 for women (Anušić, O'Keefe, and Madžarević-Šujster, 2003: 26).

Homeland War veterans represented (for HDZ) elite welfare stakeholders that have to be entirely excluded from any reform. Additionally, separate laws granted much longer insurance periods (up to 18 months *per annum*) to a series of professions, usually involving unhealthy and risky jobs, and regulated retirement of police officers, professional soldiers and fire-fighters, other favoured constituencies of HDZ (Narodne Novine, 71/99, 128/99). Table II.9 summarises policy differences between proposal and output.

Table II.9 Policy compromises

	Reform proposal	Reform output
First pillar		
Retirement age	65 for all	60 for women and 65 for men
Minimum pension	0.5% yearly accrual	0.825% yearly accrual
Indexation	Price	Swiss
Second pillar		
Contribution rate	Stepwise increase to 10% of gross wages	Not less than 5% of gross wages
Start of operations	January 2000	Postponed

In contrast to the above, the difficult attempt to rationalise the powerful Croatian public administration deserves some merit. Both the reorganisation of contribution collection and the organisation of pension funds supervision elicited internal opposition. According to Cook, bureaucratic welfare stakeholders are among the most reluctant to give in. In fact, HDZ's strategy entailed a mixture of concessions and cutbacks.

In order to appease the Tax administration and the Institute for Payment Transactions (ZAP), the government retained or expanded their tasks. Contribution collection was gradually incorporated into the Tax administration. By 2001, it became responsible for all mandatory insurance contributions, taking the Croatian Health and Pension Insurance Institutes' tasks over, including part of their employees. The unified control and enforcement of all payroll taxes followed. The Financial Agency (Fina), the successor of ZAP, continued to physically withhold contributions from employers (Narodne Novine, 67/01; Bejaković, 2004: 72-73).

Data management for the funded pillars was instead delegated to the Central Registry of Insured Persons (Regos). This was inspired by the Swedish pension reform and shaped as a central clearinghouse insulating employees from employer pressures (World Bank, 2000: 2). The Registry's tasks include: registration of the insured to second pillar funds, cross-checking of paid-in contributions with reports submitted by employers, and maintenance of a central database capable to provide information to pension funds and authorised institutions (Bejaković, 2004: 71). Yet the later attempt to create a central database for all contributions wrecked against the opposition of competing bureaus.

Finally, the creation of a specialised Agency for Supervision of Pension Funds and Insurance (Hagena) was the only available choice as existing agencies – the Croatian National Bank (HNB), the Securities Commission, the Authority for the supervision of insurance companies – refused to take on the task. Hagena, subordinated only to the *Sabor*, was established during 1999 to license and supervise mandatory and voluntary pension funds, the respective management companies and Regos. Once the system started to run smoothly, the necessity for an integrated approach emerged, especially due to the overlap of supervision and regulation of investment and pension funds. Three agencies merged during 2006 into Hanfa, the Croatian Financial Services Supervisory Agency (Narodne Novine, 140/05).

Reform outcomes

The Pension Insurance Act was adopted in July 1998 and implemented in 1999, the Funds Act and the Annuities Law were legislated in May and October 1999 respectively, and the first contributions to the funded pillar started flowing in January 2002 (Narodne Novine, 102/98, 49/99, 106/99). The acts structurally overhauled the Croatian retirement system. The PAYG scheme turned into a drastically downsized, two–tiered defined benefit point system, and two supplementary defined contribution funded pillars were added, one mandatory and one voluntary. The main changes include:

- Gradual, semi-annual increase in retirement age from 55/60 to 60/65 years for women/men (completed in 2009).
- Reduced work-period entitlement and elimination of entitlements by length of career. Old-age pensions are granted only upon reaching the retirement and having 15 years of service at least. The common ex-Yugoslav right to acquire an old-age pension with 35/40 years of service for women/men was cancelled by 2009.
- Gradual increase in minimum early retirement age from 50/55 to 55/60 for women/men. Permanent decrement for early retirement increased to 0.3% for each month missing before reaching full retirement age, hence maximum 18% in five years.

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- Widening of the calculation period from 10 best consecutive years to full career. The calculation period is raised by three years *per annum* (completed by 2010).
- Change in the PAYG benefit formula. All participants have at least part of their pensions calculated according to a point formula: APV x PP x PF, where APV = Actual Pension Value, PP = Personal Points and PF = Pension Factor (PF). A personal point indicates the proportion of an individual's wage relative to the national average wage. Second pillar participants' benefits are determined by a two-tiered formula, the basic pension, consisting of a point-based part and a flat, service-related component. Basic pension = 0.25 x APV x PP x PF + 0.25% x W x Y, where W = average gross Croatian wage for the preceding year and Y = years of service.
- Introduction of a minimum pension for the participants to the new public pillar (not the funded one): 0.825% of average gross Croatian wage for the preceding year for each year of service.
- Introduction of the 'Croatian formula', which uses mixed price-wage indexation and valorisation.

Notwithstanding the two-year delay in second pillar implementation, participation in the multipillar system proceeded smoothly. It was mandatory for all the insured under 40 and optional for those aged between 40 and 50. Table II.10 presents a schematic summary of the new pension system.

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Table II.10 Multipillar system in Croatia

Pillar	Zero (non-contributory)			First (mandated, earnings-based)			Second (mandated, earnings-based)			Third (voluntary)		
Provision Financing Objective	Public	Tax-financed Means-tested Basic Benefit	Poverty alleviation	Public	PAYG Non-financial Point System	Insurance	Private	Financial Defined Contribution	Insurance	Private	Financial Defined Contribution	Insurance

	Benefit	Coverage	Eligibility	Benefit level	Indexation	Beneficiaries	Expenditures %GDP
Basic pension - Zero pillar	Guaranteed Minimum Income	Entire population	Persons with income below the Guaranteed Minimum Income	Percentage of state-defined subsistence allowance	*Ad hoc*	2.7% of population (2005)	0.22

		Vesting period	Contribution rate	Contribution floor and ceiling	Benefit rate	Assessment base	Retirement age	Indexation
Old-age pensions – First and second pillars	1st	15 years	TCR: 20.0% employee	35% average wage 600% average wage	Basic flat pension plus point system	Swiss-valorised lifetime earnings	60 for women and 65 for men in 2009	50% wages and 50% prices
	2nd	15 years	PCR: 5.0% employee		Depending on life expectancy and RoR	Accumulated funds		Prices

	Vesting period	Retirement age	Tax treatment (contributions, returns, benefits)	Contributions tax deductible for employers	Lump sum payments possible
Supplementary pensions – Third pillar	No	50	Exempt Exempt Taxed Contributions up to HRK 12,000 are deductible from PIT	No	Yes

Source: Holzmann and Guven (2008). PCR – Pillar-specific Contribution Rate. PIT – Personal Income Tax. RoR – Rate of Return. TCR – Total Contribution Rate.

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Distributional consequences

Proposition 3 contends that there is a fundamental trade-off between the fiscal and social objectives of a pension reform. Specifically, excessive internal savings conflict with sound social policy and failure to withstand vested interests jeopardises fiscal stability. Nowhere as in Croatia is the trade-off so marked, or the government's actions so inconsistent and in need of a correction. The 1999 pension reform prioritised fiscal sustainability and economic competitiveness over equity and (partly) efficiency in the reformed schemes. With respect to the social adequacy of the system, two issues stand out: HDZ used double standards with respect to future beneficiaries, shifting the financial burden of privileged and already retired pensioners onto the new generations; the funded pillar is too tiny and yields insufficient returns to compensate for the new formula. As a result, the rapidly declining replacement rates triggered a series of politically motivated and inefficient policy reversals. These partly undermined the initially very favourable fiscal prospects of Croatian public pensions, which will require a longer period to eliminate unwarranted deficits.

Public pillar adequacy

The new benefit formula generates what Puljiz (2007: 188) calls the 'new pensioner debt', that is, a discrepancy between the benefits of 'old' and 'new' pensioners. At the heart of the problem lies the initial computation of the Actual Pension Value (APV) to guarantee continuity between pensions calculated according to the old and new formulae.

The APV was used as an obfuscation device to achieve substantial fiscal savings (Vjesnik, 10 September 2003). The initial value was determined in line with the 1998 level of average pensions, not including supplements (Narodne Novine, 31/99). To do this and comply with ILO Convention 102 (40% replacement rate with respect to net wages of qualified male workers), average wages of construction workers were used.

As a result, the gap between 'old' and 'new' pensioners is widening fast. Average pension benefits are falling. The difference in the net replacement rate between 'old' and 'new' pensioners in April 2008 was almost nice percentage points (one fourth in absolute terms). The number of beneficiaries on minimum pensions is increasing: whereas in 2002 just a fourth of new pensioners were granted the minimum pension supplement, this figure rose to two thirds by 2005 (Vjesnik, 31 May 2006). The requirements for benefits above the minimum, in terms of average earnings and insurance period, are very exacting. Nestić and Rašić Bakarić (2008: 94) show that 90% of average lifetime earnings obtain only the minimum pension, irrespective of the insurance period.

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In addition, shorter accumulation is extremely harmful for women. The campaign against equalisation of retirement age is over. In April 2007, the Constitutional Court ruled the unconstitutionality of differential treatment of men and women in the Pension Insurance Act and gave time until 2018 for the *Sabor* to amend the law (Narodne Novine, 43/07). The debate is underway: given that Croatia faces worsening demographic indicators, the prospect of increasing the minimum pensionable age to 67 or 68 is now being considered (Vjesnik, 5-6 May 2007).

As for merit pensioners, Table II.11 shows that they are indeed in a more privileged position. Merit pensions are still copiously financed through budget transfers. Homeland War combatants are the fastest growing category. Their average insurance period is only twelve years and average pensions during 2008 were higher than the average wage. By 2007, the beneficiaries of privileged pensions amounted to 15.8% of total pensioners and their number is still swelling.

Table II.11 Merit pensions 1999-2007

	1999	2003	2007	Replacement rate*
WWII veterans	73,466	68,206	50,187	49.69
Police and judiciary	12,816	16,567	16,299	72.78
Executive Council of the *Sabor*	126	524	369	48.73
Croatian Academy of Sciences and Arts	79	152	160	155.00
WWII Home Guard veterans	34,090	30,102	23,328	41.30
Yugoslav National Army members	16,217	14,467	12,469	56.52
Former political prisoners	5,668	5,765	5,727	71.46
MPs	112	296	399	189.94
Croatian army	2,364	7,919	11,344	63.73
Croatian Homeland War combatants	26,110	32,249	56,374	113.15
Total	**171,048**	**176,247**	**177,004**	

Source: HZMO. *Average pension per category on average wage in 2007.

Despite the great political-institutional shift in 2000, the tinkering with merit pensions continued unabated. This elicited major rancour by ordinary pensioners, who deemed these privileges the emblem of authoritarian HDZ policymaking. The Social Democratic Party's greatest affront was that MPs were granted even more generous privileges (Narodne Novine, 55/00). A chorus of disapproval followed, as well as appeals to the Constitutional Court (Vjesnik, 12 May 2000). Yet the latter found it legitimate for the government to grant certain tax-financed privileges. Even HDZ had been aware that the *Sabor* should not unnecessarily play with this issue.

SDP acknowledged the *faux pas* and soon back-pedalled to temper the growing unease. Maximum pensions for MPs and veterans were limited to twice the maximum ordinary pension and the benefits for privileged categories were decreased by variable amounts up to 20% (Narodne Novine, 82/01). In addition, SDP tried to deprive the combatant status of its

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overestimated dignity and to monitor regional committees responsible for assigning privileges, which operated under the Ministry for Homeland War combatants (Puljiz, interview).

Despite pledges to the contrary, the Croatian Democratic Union's clientelistic practices did not cease after its return to power. Homeland War combatants granted disability status actually multiplied, often as a result of Post-Traumatic Stress Disorder. HDZ redrew veteran pension benefits: the minimum pension cannot be lower than 45% of the Croatian average net wage and they are entitled to conspicuous supplements (depending on the time spent fighting) for insurance periods lower than 40 years (Narodne Novine, 174/04). Hence, almost half a million relatively young men are entitled to very high, tax-financed, not means-tested benefits, which is socially unfair, distortional and financially detrimental (Anušić, 2007).

Private pillar adequacy

If the funded pillars were meant to increase the system's overall effectiveness and compensate for the shortcomings of public schemes, this objective has been missed in Croatia. The second pillar is excessively small, thereby raising oligopoly concerns. At least initially, administrative fees were excessive and investment limits too stringent. Two amendments to the Funds Law (under SDP in June 2003 and under HDZ in June 2007) rectified the main flaws. Yet the supplementary schemes were until recently almost non-existent.

The 5% contribution rate is inadequately low to compensate for falling replacement rates in the PAYG pillar. After 2003, HDZ squandered most public pension savings to pay for both the old and new pensioner debts. This contradicts its intent to increase contributions to the second pillar, contained in the Strategic framework for development 2006-2013 (Vlada RH, 2006: 48). Each percentage point increase would cost the government some almost 0.4% of GDP, an unviable option under current circumstances (Vjesnik, 14 November 2007).

Aside from technical details, the establishment of the second pillar ran smoothly since 2002. Initially, Hagena licensed seven mandatory funds and relative management companies. Direct marketing had almost no influence on membership (Anušić, O'Keefe, and Madžarević-Šujster, 2003: 59-60), as the brands of banks involved in pension fund management affected choice most crucially. Zagrebačka banka, Raiffeisen Bank and Privredna banka Zagreb – Croatia Osiguranje (PBZ-CO) attracted almost 90% of all members. Hence, the market is almost consolidated and consists of two bigger (AZ and Raiffeisen) and two smaller funds (Erste Plavi and PBZ/CO), which attracted 1.4 million members by the end of 2007, see Table II.12. The 'Association of Croatian Pension Funds Management Companies and Pension Insurance Companies' represents the funds at domestic and international levels.

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Table II.12 Pension funds market

	AZ	Erste Plavi	PBZ/CO	Raiffeisen	Total
Membership					
31 Dec 2007	**510,098**	**211,886**	**231,070**	**442,639**	**1,395,693**
Share in %	36.6	15.2	16.6	31.7	100.0
Net assets HRK million					
31 Dec 2007	**8,272**	**2,707**	**3,540**	**6,483**	**21,002**
Share in %	39.4	12.9	16.9	30.9	100.0
Net contributions HRK million					
Jan 2002 – Dec 2007 (total)	**7,342**	**1,854**	**3,025**	**5,483**	**17,703**
Jan – Dec 2007	1,592	478	674	1,251	3,995
Gross rate of return					**Mirex**
Apr 2002 – Dec 2007 (total)	7.12%	8.11%	7.88%	7.85%	7.60%
Dec 2007 (year-on-year)	6.38%	6.05%	7.66%	6.90%	6.81%
Units of account 31 Dec 2007	147.72	155.68	153.80	153.54	151.56

Source: Hanfa.

Although it is probably overstated, there is a risk of oligopolisation of the market (cf. Guardiancich, 2007: 132-134). The cleavage between bigger and smaller funds is exasperated through barriers to entry (high membership requirements) and deterrents to switching (Vlaić, interview). In particular, the Central registry (Regos) automatically allocates new members who fail to make a choice to a fund according to its market share. The two smaller players of course deplore this. If the educational campaign raised initial awareness, in 2006 only one fifth of new members selected a fund voluntarily. In a market consisting of just four funds, any further concentration implies a failure of privatisation in the pension system.

In general, the funded pillar's performance has been satisfactory.[15] However, two factors determined that its potential was not exploited: minimum investment limits and excessively high administration fees.

Finance Minister Škegro required additional assurances not to overshoot the budget under worsening economic circumstances in 1999. The minimum investment limit for state and Croatian National Bank (HNB) bonds was set at 50% of mandatory pension fund assets, which is unprecedented in Central, Eastern and Southeastern Europe. Initial calculations showed that first year's transition cost would amount to HRK 2.5 billion, while the Ministry of Finance claimed to have half that at disposal. Thus the minimum limit was an effective way to avoid excessive budget deficits (Anušić, interview), but it simultaneously resulted in a *de facto* redundancy of the

[15] Until 2008, when the subprime mortgage crisis and Croatian idiosyncrasies, such as a growing number of risk-averse small investors, generated negative returns. The Mirex, i.e. the weighted average of all units of account, slid by October 2008 back to its July 2006 value, thereby losing two years of revenues.

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funded pillar. By 2008, less than 2% of gross wages was invested into non-state securities (see Table II.13).

Table II.13 Portfolio structure 31 December 2007

Asset class	Amount (million HRK)	Share in %
Domestic assets, o/w	20,298	95.7
Securities and deposits	19,947	94.1
Shares + Global Depositary Receipts	3,128	14.8
Government bonds	13,485	63.6
Open investment funds	2,543	12.0
Foreign assets, o/w	905	4.3
Shares	689	3.3
Total gross assets	21,202	100.0
% of GDP	7.71	

Source: Hanfa.

Recent developments at least partially offset the funded pillar's marginalisation. In addition to domestic liberalisation in June 2007 of (for example) investment into public joint-stock companies, minimum limits will be eliminated upon accession of Croatia to the European Union. The *acquis communautaire* obliges member states to comply with its rules on the free movement of capital (Narodne Novine, 71/07).

The Funds Law had introduced an irrational fee structure and barriers to entry. Consequently, in 2003, licensing requirements were relaxed, the excessive switching fee drastically reduced and the success fee repealed. However, as a compensation for the low contribution rate, the management fee was increased to 1.2% of net asset value. Anušić (2007) values the long-term reduction in assets at 26%, definitely too much. Failure by the industry to self-regulate and moderate costs forced the Croatian Financial Services Supervisory Agency to lower the maximum applicable management fee in 2008.

Finally, the third pillar is a partial disappointment. Various design flaws, e.g. the lack of tax incentives for employers, and low public awareness prevented the voluntary funds from taking off. Lately the situation is improving. By the end of 2007 there were six open-end and twelve closed-end voluntary funds on the Croatian market. The former totalled 104 thousand affiliates, while the latter had 12 thousand members.

Fiscal viability

The fiscal implications of the 1999 reform were initially very ambitious: public pension outlays should have declined to 6% of GDP by 2040, which would have created enough savings to increase second pillar contributions. However, the introduction of various costly amendments, starting with the Small pension law in 1998 and finishing with the repayment of the new pensioner debt in 2007, imply that the system will break even only around 2040 (Holzmann and

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Guven, 2008: 86), thereby rendering the diversion of more money to the funded pillar – a reasonable condition to compensate for public pillar shortcomings – very difficult.

Two additional contrasting effects are worth mentioning. In order to gain in competitiveness, contribution rates were first lowered by 2% in 2000 and later fixed at 20% and charged entirely on employees. This worsened the fiscal balance of HZMO. If contributions almost entirely covered expenditures in 1994, they financed less than 58% of total outlays in 2001. After that, a formidable improvement in contribution coverage significantly ameliorated the situation.

The Central Registry, Regos, correctly assigns the vast majority of contributions to second pillar individual accounts and is at least partially responsible for the huge advances in contribution collection. This substantially lowered the budget transfers needed to finance HZMO. By 2007 contributions already paid for 70% of total expenditures. Regrettably, the Central Registry's mandate has been recently restricted and the rationalisation of public revenues brought to a halt (see page 77 below).

Political sustainability

As was already frequently mentioned, the post-Tuđman era is characterised by the spectacular undoing of public pension reforms. Proposition 4 clearly argues that negotiated bargains are qualitatively very different from one another. Divisive policymaking and limited bargaining may not only result in the uneven allocation of gains and losses, but may also fail to build the incentives for continuing political support. The Croatian case is an archetypical example of both. Neglected and dissatisfied interest groups (trade unions and pensioner associations) reactivated after implementation started and encouraged each subsequent government to renege on earlier commitments and propose very costly and inefficient measures. These proved important to gain electoral support; after all, pensioners were decisive in the 2000, 2003 and even, given HDZ's populist surge, in the 2007 electoral round. The final result of the reversals are a weakened link between costs and benefits in the public pillar, an increase in future deficits and, consequently, the impossibility to further expand the funded pillars. Ultimately, also the state bureaucracy managed to successfully oppose its own rationalisation.

Involution in public pensions (under SDP)

"Decisive… perhaps" was the unforgiving phrase used to describe both PM Ivica Račan's executives. In pension affairs as well, the Social Democratic Party never found a balance between populism and fiscal austerity. A series of contradictory acts simultaneously alienated ordinary pensioners and set in motion the populist decay that followed the rebirth of the Croatian Democratic Union under PM Ivo Sanader.

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The honeymoon with pensioners, who supported the communist successor party at the 2000 elections, was particularly short-lived. The pre-electoral Social agreement, signed in December 1999 as a reaction to HDZ's disregard for the obligations towards pensioners, was a blessing in disguise, since it haunted the new incumbents throughout the entire period in power. The winning coalition agreed to uphold the Constitutional Court's decisions regarding *ad hoc* indexation during 1993-95, indemnify further devaluation, decouple social assistance from pension insurance and secure the timely payment of pensions.

Not only were the promises excessive, the proposed timing was unrealistic: the *Sabor* had six months to pass a pension debt law, while full indexation had to be achieved in two years' time, starting in 2001 (Vjesnik, 20 June 2000).

In June 2000, Labour Minister Davorko Vidović (SDP) presented a realistic repayment plan, given the existing budget restrictions. The final version, the Pension increase act (Narodne Novine, 00/127), relied on cash transfers and earmarked some 1.2% of GDP per year to increase benefits between 0.5% and 20%, depending on the year of retirement and reference salary. Despite some initial warmth, the Pension increase act fell short of pensioners' demands, which were nothing less than retroactive wage indexation for the missing years.[16] Moreover, the increases were regressive: low-income pensioners either lost these increments or obtained lower-than-expected benefit hikes (Vjesnik, 9 December 2000). That the government considered the 1998 Constitutional Court's decision fulfilled only exacerbated the dissatisfaction of pensioner associations and coalition partners.

The clash worsened as SDP ignored and aggravated, for obvious fiscal reasons, the rising problem concerning 'new' pensioners' falling replacement rates. The public was shocked to learn that the social democrats curtailed minimum pensions (the accrual rate for each pension qualifying year above 30 was halved) and increased decrements for early retirement (Narodne Novine, 147/02).

Ultimately, the public saw the social security system as a lottery, due to the swift implementation of stricter conditions and the progressive elongation of the calculation period (Vjesnik, 16 December 2002). As expected after so much meddling, SDP's well-intentioned future reform plan, the Strategy for the development of the Republic of Croatia: 'Croatia in the 21st century' (Narodne Novine, 97/03), lost all its credibility.

[16] Fulfilling such demands would have cost the state HRK 140-210 billion over 10 years, that is between 92-138% of Croatian GDP in 2000.

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Involution in public pensions (under HDZ)

Counterintuitively, the return of HDZ to power only aggravated the reversal of the 1999 reform, which reinforces the argument that limited bargains breeding divisions do not create continuing support for the underlying policies. If pension reforms are seen as a process and not as an event, as presupposed in Proposition 4, politically stable policies have to withstand shocks in political power (e.g. alternation in government). Croatian policymakers evidently were not able to put into place such incentives.

During 2003, the crumbling centre-left coalition was in a similar position as HDZ during 1999. Premier Račan and Labour Minister Vidović could not justify their policies vis-à-vis the elderly. Pensioner associations' *leitmotiv* was that neither the previous, nor the incumbent governments had repaid their debts: HDZ negated the Constitutional Court's 1998 decision and SDP failed to fulfil the 1999 pre-electoral agreement.

Pensioner associations decided to run united, independently at the 2003 elections and they delegated representation to Vladimir Jordan's Croatian Pensioner Party (HSU) (Vjesnik, 4 November 2003). Due to the proportional electoral system, Ivo Sanader's Croatian Democratic Union scored a convincing, but not overwhelming electoral victory. Hence, the future premier's main concern was finding a suitable coalition partner.

As the available options shrunk, the three seats obtained by HSU became fundamental. In order to secure their vote, Sanader reneged on key elements of the 1999 pension reform and signed the suicidal Agreement of support with pensioner representatives (Vjesnik, 8 December 2003), which will be remembered as the dearest in Croatian history. As Table II.14 neatly shows, the promises to coalition partners and external supporters paled in comparison to the HDZ-HSU pact.

Table II.14 The HDZ-HSU agreement

Within the first 100 days of government	Resumption of wage indexation.
	Inclusion into the pension base of the HRK 100 + 6% supplement.
Until 30 June 2004	Fulfilment of the 1998 Constitutional Court's decision.
	Introduction of additional yearly indexation to GDP growth until the replacement rate reaches 70% (intermediate objective of 50% by January 2005).
During 2004	Improvement of retirement conditions for pensioners not participating to the funded pillar.
	Redefinition of the membership of the HZMO Board.
	Total exclusion of persons older than 65 from medical expenses.

Source: HSU (3 December 2003).

Pension-related populism started with great fanfare in February 2004, when a common pensioners-government committee was established by HSU leader Vladimir Jordan and Sanader's narrow cabinet (Vjesnik, 13 February 2004). The committee produced a major amendment to the Pension Insurance Act already by March 2004 (Narodne Novine, 30/04). This included policy and office concessions. Wage indexation resumed and Njavro's supplement got

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included into the pension base. Tax and health care contribution exemptions for pensioners were broadened. Finally, the government redesigned the HZMO board in favour of the insured: instead of seven, the Labour Minister appoints now four members. Pensioners, trade unions and employers nominate three representatives each, instead of two. (Vjesnik, 2 March 2004).

After reaching this peak, relations between the government and pensioner associations rapidly soured, due to the fiscal impossibility of financing HSU's excessive demands. The IMF played a pivotal role by pointing out that while the pensioner debt constituted a judicially sanctioned right, wage indexation was purely political and unsustainable (Vjesnik, 4 November 2004). The stand-by arrangement signed in August 2004 weighted heavily on PM Sanader's choices. As expected, the government did not contemplate the additional, yearly indexation to GDP. After securing the external support of the far-right Croatian Party of Right (HSP) at the 2005 local elections, Sanader *de facto* breached the HDZ-HSU agreement with impunity (Vjesnik, 20 June 2005; Narodne Novine, 92/05).

Despite disappointment, pensioners did not terminate the collaboration with HDZ. Talks on the restitution of the pensioner debt were still underway and the 'new' versus 'old' pensioner affair was only starting to swell. Dealing with the two issues elicited another populist wave, which again clashed against the 1999 reform financial objectives and HDZ's purported intentions to increase the contribution rate to the funded pillar over the following years.

The old pensioner debt was settled during 2005. The Pensioner fund act (Narodne Novine, 93/05) established a fund to be filled by state assets and budget transfers, with the exclusive aim of carrying out the 1998 Constitutional Court decision. Repayment could take two forms: half of the entire amount over two years; and the whole amount in six yearly instalments starting in 2007 until 2012 (Narodne Novine, 139/05). Of the 426 thousand eligible pensioners, 74% chose the swift method.

This figure was much higher than what the government hoped for (less than 5%) and raised the pensioner debt bill from 3.5% to 6.0% of GDP (HZMO, 7 February 2007). The IMF did not endorse the manoeuvre, since the first instalment would have worsened the budget deficit, if not financed through privatisation revenues (Bejaković, 2006). The old pensioner debt saga ended in 2007, when the government gave in to the reimbursement of the debt for previously excluded survivors and high-income pensioners. This added another HRK 1.4 billion to the bill (Vjesnik, 25 April 2007).

The last straw that definitely nullified the possibility to expand the funded pillar was the solution to the 'new' pensioner debt problem. As the electoral year 2007 approached, the perceived inequality between the two cohorts gained in salience.

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Previously divided and uninterested trade unions joined forces and proposed a whole series of correctives: shorter calculation period, *ad hoc* increases, new computation of the Actual Pension Value and higher minimum pensions (SSSH, 2006). The Croatian Trade Union Associations (HUS) collected 330 thousand signatures for the equalisation of 'old' and 'new' benefits. Furthermore, 30,000 people gathered on 1 May 2007 in the centre of Zagreb demanding 'reform of the pension reform' (Vjesnik, 15 February 2007, 2 May 2007).

The political dispute was even more heated. During October 2006, after the Croatian Peasant Party submitted to parliament an amendment to the Pension Insurance Act, PM Sanader's government fully endorsed the issue and established a new working group. The political budget cycle started to mount. Former Labour Minister Vidović (SDP) unveiled a financial project costing 1% of GDP to equalise benefits between cohorts and to introduce social pensions (Vjesnik, 15 February 2007).

All parties, except for HDZ, endorsed SDP's legislative proposal. Sanader refused and declared that 'new' pensioners would be fully compensated during the fall. It was a magistral electoral move. After extensive negotiations between the executive's restricted cabinet and the Croatian Pensioner Party, Sanader gave the green light to a spectacular deal that probably earned him reelection (Vjesnik, 12 July 2007). By fulfilling most promises to pensioners, Sander also belittled the HSU for having a single-issue manifesto (Vjesnik, 1-2 December 2007).

As with the other post-1999 amendments, these benefit hikes run against the logic of the paradigmatic reform. In order to balance the differences between cohorts, the government granted supplements ranging from 4% to 27% for 'new' pensioners retired during 1999-2010 (Narodne Novine, 79/07). It was a conspicuous increase with respect to the original proposal, which entailed much lower supplements. In addition, Sanader handed out many other goodies: higher minimum pensions, much lower decrements for early retirement and increased pension factors for disability benefits. All these entered into force during 2008 (Narodne Novine, 35/08), creating strong disincentives to work longer, definitely breaking the actuarial link between contributions and benefits, and *de facto* rendering an expansion of the funded pillar impossible.

Involution in public administration

The Croatian case also illustrates that Proposition 4, i.e. that limited bargaining may undermine the political sustainability of reforms, does not hold only for social partners or partisan actors, but also for other elite welfare stakeholders that have disproportionate power in post-socialist countries. The 1999 reform envisaged a complete rationalisation of the powerful state bureaucracy dealing with pension issues. Whereas the centralisation of contribution collection in the Tax administration and consolidation of pension funds supervision in the

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Croatian Financial Services Supervisory Agency worked out smoothly, the unification of data management in the Central Registry, Regos, failed. HDZ's insufficient resolve to tackle the public administration's multiple interests is to blame for the negative result. Failure to craft an acceptable deal to the parties involved brought restructuring to a complete halt.

Despite its efficiency, the establishment of yet another data collection agency in a small country like Croatia is uneconomical (Anušić, interview). The plan was therefore to broaden the tasks of this institution and anchor them within an existing organisation. Consequently, during 1999-2002 the agency started to collect the data on all payroll contributions, taxes and surtaxes (Narodne Novine, 114/01, 153/02). This expansion aimed to create a single database for all Croatian public bureaus, thereby threatening the existence of hundreds of overstaffed and wasteful offices. Given that HDZ's power decreased substantially, negotiations with agencies that owned sufficient IT to manage such flow of information invariably failed.

The Central Registry's responsibility was confined to first and second pillar contributions as of 2005 (Narodne Novine, 177/04). The official explanation was the incompatibility between Regos datasets and those used by the Tax administration (Bejaković, interview). More plausibly, Regos fell prey to the Tax administration, HZMO and Fina. These agencies pressured the HDZ government to maintain their own data collection functions and staff (Matković, interview). The setback had only a temporary negative effect on contribution collection, yet the future of Regos is still uncertain. The Registry is financed through the general budget and is relatively expensive (although most of the money pays for external state-provided services). Part of these costs should be borne by the insured who are the ultimate beneficiaries. The options are either to merge Regos with another agency, privatise it, or finance it entirely with pension contributions (Vjesnik, 14 November 2007). There is no consensus on the practical details, yet what matters is that the rationalisation of this administrative branch has been definitively brought to a halt.

Conclusions

The chapter shows that the 1999 paradigmatic pension reform in Croatia is a primary example of unilateral, divisive policymaking within an unbounded political-institutional environment. Policymakers prioritised the reform's fiscal objectives at the expense of other redistributive elements, and simultaneously nurtured elite welfare stakeholders not to disperse their vote. This had two negative repercussions during implementation. First, social adequacy of pension benefits was not guaranteed. Second, the uneven distribution of gains and losses did not secure continuing support for the new retirement system, which already underwent significant policy reversals.

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Among the four case studies analysed in this dissertation, Croatia experienced the most traumatic extrication from socialism and the longest delay in the consolidation of democracy, during the hegemony of President Franjo Tuđjman's Croatian Democratic Union. More than elsewhere, extremely bad structural indicators – a consequence of the war and the drift into crony capitalism – eliminated the possibility to refinance the system or to cut benefits and simultaneously preserve its original structure. In line with Proposition 1, which argues that restructuring is a way out of the impasse during a deep pension system crisis, the impossibility to further cut benefits (as sanctioned by the Constitutional Court) prepared the stage for one of the most radical retirement system overhauls in Central, Eastern and Southeastern Europe, and one that introduced many elements of the new pension orthodoxy.

According to Proposition 2, fundamental restructuring opens up greater room for political manoeuvre. In Croatia, an overwhelming majority of insured favoured a switch to funding. Hence, the government could claim credit for increasing the system's efficiency, while obfuscating its real agenda. Fiscal sustainability and a reduction of contribution rates to bolster economic competitiveness were in fact the leitmotiv that guided the process. That financial viability was the foremost priority is testified both by the radicalism of the reform outcome and by the lack of safeguarding redistributive elements. Fiscal objectives prevailed over both equity concerns and overall effectiveness.

In the political arena, the conservative government engaged in very limited bargaining with social partners and other actors. HDZ mainly aimed to fulfil its vote-seeking goals by granting privileges to its constituencies (such as an increasing number of merit pensioners, in particular the Homeland War combatants). It has to be stressed that Croatian policymakers stuck to the original policy objectives: they disproportionately cut future benefits and deliberately omitted to indemnify pensioners, who paid much of the country's war bill during the early years of transition and whose demands were backed by a Constitutional Court's decision.

Such conduct was possible due to the political-institutional configuration of the country. Within this 'very-presidential' system, where the separation between the executive and legislative power was non-existent, Croatian policymakers could afford an elitist and imposed approach: social partners experienced dialogue as instructions and external conditionality as diktat (Maršić, 2004: 87-88). The opposition was not consulted and ultimately voted against the bills. The reform was based on minimal support and, hence, the Croatian case presents the worst traits characterising divisive policymaking by an unconstrained executive. Furthermore, and differently than in Hungary – the other case where imposition took place – the Croatian executive did not meet any organised, not even internal opposition.

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The drastically downsized two–tiered point system and two supplementary funded pillars replaced the old PAYG pillar. The immediate switch to the new calculation formula marked a similarly brusque rupture with the past as the Polish reform. Despite the technical prowess, the prioritisation of financial viability and the limited bargaining involved had dear consequences for future popular and political support. As envisaged by Proposition 3, which predicts a clash between sound social policy and budgetary thrift, distributional conflicts emerged almost instantly. Policymakers excessively emphasised the system's financial viability, at the expense of social adequacy. According to Holzmann and Guven (2008: 86), all public pension deficits are bound to disappear in the long term, despite subsequent policy reversals and lower contribution rates. The radicalism of the 1999 pension restructuring materialised in a number of technical solutions, which obfuscated the real impact of reforms on individual benefits. In none of the four countries is the trade-off between social adequacy and fiscal viability so marked: pensions are bound to free-fall and this will finance both the partial privatisation and privileged retirees. Finally, the funded pillar is too small to compensate for lower public benefits, again a consequence of excessive preoccupation with budget deficits and economic competitiveness.

As for the new system's political sustainability, Proposition 4 stresses the importance of inclusive policymaking to ensure continued political support at all levels. This was of course not the case in Croatia, which experienced some of the most spectacular policy reversals during reform implementation. After the country embarked on a stable democratic course, its political-institutional configuration changed radically. The division of powers was rebalanced and pluralism restored. Previously subjugated interest groups reorganised (trade union confederations, pensioner associations and the state bureaucracy) and started playing a fundamental role in Croatian social policy.

The turn from semi-authoritarianism to democratic politics hastened the activation of previously excluded actors and a period of policy involution began. Pensioner associations and the tiny Croatian Pensioners Party (HSU) started to disproportionably influence pension politics. Their support to the centre-left coalition, first, and to a weak centre-right coalition, later, marked the outright rejection of the 1999 reforms and generated the demand for greater redistribution within the public pillar.

Two policies stood at the origin of pensioners' volte-face. Policymakers disregarded the Constitutional Court's decision establishing a right to indemnification for pensioners and obfuscated excessive, unsustainable benefit cuts within the public pillar. If the pro-welfare coalition, consisting of trade unions, pensioner associations and the social-democratic opposition had been included in policymaking, neither measure would have been possible. The

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indemnification of pensioners would have been addressed and greater redistributive elements introduced, at the evident expense of other policy goals.

The consequence of this uneven distribution of gains and losses, a feature of Proposition 4, was that the reversal of some policy measures became firmly entrenched in the agenda. Both trade union confederations that overslept the 1999 reforms, and the state bureaucratic apparatus which had to be rationalised, reacted against the reform package and successfully reversed parts of it. In comparative terms, the Croatian case is that of a reform success turned awry. The results of the involution above are a weaker contribution-benefit link and the halt to public administration restructuring. Very costly compensation measures prevent the expansion of the funded pillar, which may contribute to offset excessively low benefits in the public pillar. Whereas the new pension system has not suffered a breakdown, fundamental corrective countermeasures are probably needed.

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III. Hungary

Introduction

The Hungarian political-institutional structure ensures that its governments enjoy unchecked executive authority. The electoral system qualifies the country as a pluralitarian democracy and the constructive vote of no confidence prevents governments from being easily ousted. Hence, policymaking often involves limited bargaining and decision-makers are only accountable to their immediate constituencies.

With respect to pension reforms, Hungary is probably one of the most remarkable cases in Central, Eastern and Southeastern Europe. The partial absence of unrelenting crisis within the retirement system and general public unawareness hints to the possibility that the Natali-Rhodes trade-offs may be instrumentally abused to artificially generate consensus and/or support an ideologically biased reformist vision. This is, however, not the primary purpose of this case. Studying Hungary in fact shows that even under relatively stable democratic conditions, unconstrained executives that operate in antagonistic party systems legislate costly deviations from efficient practice and unevenly distribute gains and losses. Similarly to Croatia, the Hungarian case illustrates the possibility that narrowly targeted policies are very vulnerable to sudden shocks in political authority.

Instead of undergoing a steady democratic consolidation, Hungary experienced increasingly rash electoral competition. The country resembles a two-party system, whose main competitors embody different developmental visions, professionalism in politics and policymaking styles. Whereas legislation of pension reforms took place during a period of politics as usual, its implementation started during a phase described as 'de-consolidation'. The sudden alternations in political power did not provide the necessary stability for the correct functioning of such complex policy.

In comparative terms, one parallel with Croatia is that Hungarian limited bargaining and clientelism markedly differs from the consensus-building attempts in Slovenia and Poland. However, the similarities with the Westernmost Balkan country end here. Hungary was regarded as a democratic success during the late 1990s, and was poles apart from the semi-authoritarian methods employed in Croatia. Although Hungarian executives were indeed unconstrained, the pro-welfare coalition was much stronger. The latter produced a number of alternative policy proposals that Magyar policymakers had to confront. Such diversity of opinions also existed in Poland, in marked contrast with the lack of expertise (and frequently of interest) that characterised both Croatia and Slovenia.

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The chapter proceeds as follows. The political-institutional environment is presented first. The Hungarian negotiated transition created an institutional structure that favours unconstrained executives, encourages very antagonistic bipolarity and generates sharp alternations in political power. Since legislation and subsequent policy implementation took place under two different governments, characterised by radically different policymaking styles, the chapter emphasises the nature and content of electoral and party competition. The increasingly heated electoral contests are shown to be responsible for the acute political budget cycles that started after the year 2000.

The crisis of the retirement system is studied to evaluate the applicability of Proposition 1 to Hungary. This argues that once refinancing and retrenchment become politically unfeasible options, systemic reforms involving complex negotiated bargains follow. Provided that the Hungarian pension system generated, among the ones studied, the lowest deficits and overall spending, Proposition 1 seems to hold only partially. A well positioned pro-welfare coalition, rather than systemic crisis, rendered a negotiated solution unavoidable, even within an environment where the government was unconstrained.

In order to study the impact of the supply and demand for policy innovation on the systemic features of the 1997 pension reform, the third section of the chapter traces the restructuring process. Proposition 2 stresses that these embody credit-claiming elements that can be traded for substantial benefit cuts. This again seems to only partially apply. Although the literature emphasises the number and dissimilarity of competing policy proposals, it appears the Hungarian public was unaware of the nature of reforms. Under such conditions – the operation of a democratic, but unaccountable executive and of very malleable public opinion – the chapter tries not only to answer whether the trade-offs in Natali-Rhodes' framework can be instrumentally employed to divide opposition or to appease influential clienteles, but also whether governmental propaganda can effectively influence the existence of a 'negative consensus' against public retirement.

The reform output is presented and its distributional consequences evaluated. Proposition 3 draws attention to the fundamental trade-off that exists between the future fiscal balance of a pension system and its social adequacy. In addition to analysing the public pillar, the chapter focuses on the performance of the mandatory funded schemes, which employ a corporate governance structure that sets them apart from any mainstream international practice. A particular emphasis is placed on the importance of Proposition 4 for the Hungarian system. The proposition argues that limited bargaining and the uneven allocation of benefits and losses may reduce the political sustainability of a pension reform in time. Therefore, the policy amendments

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(often policy reversals proper) enacted by the three governments that followed after the end of reform legislation are analysed. It is shown that apart from political machinations, there was no objective reason to amend (for the worse) the freshly enacted schemes. The conclusions summarise the findings for Hungary.

The transition

Before plunging into deep recession during 2007, the Hungarian transition was regarded as a success. Hungary is endowed with a stable political system, it is the closest example of two-party competition in Central, Eastern and Southeastern Europe and had, among the four cases, the lowest number of executives after 1989. Furthermore, the country enjoyed a decade of very solid economic growth and most agencies place Hungary amid the best performing transition economies.

Beneath the surface a different picture appears. In the aftermath of the 1989 National Roundtable talks, policymakers adopted institutions that would assure the creation of stable majorities in parliament and avoid the dictatorship of the latter. Consequently, Hungary ended up with one of the least constrained executives in the region (Stark and Bruszt, 1998: 171-172). The alternation between political blocks and the *de facto* impossibility to oust an incumbent government exasperated the political budget cycles accompanying each electoral round. This resulted not only in the protracted reliance on excessive budget deficits, but also in myopic policy solutions that aimed to satisfy short-term vote and office objectives.

If the return to power in 1994 of the Hungarian Socialist Party (MSzP) was marked by elitism and corruption, the ascendance of the Alliance of Young Democrats (Fidesz) was the pinnacle of such involution. During 1998-2002, this *“Hungarian version of the New Right, a mixture of populism, conservatism, and plebeian, redistributionist, economic nationalism”* (Bozóki, 2008: 191) attempted to turn the country into a chancellor democracy and started a sort of democratic ‘de-consolidation’. The endeavour was unsuccessful, however, the final descent into socioeconomic crisis, during the socialist governments led by premier Ferenc Gyurcsány, was the natural consequence of years of economic populism.

Extrication and performance

In the aftermath of 1956, socialist leader János Kádár resorted to *panem et circenses* tactics to appease the Hungarian population. A paternalistic bargaining system was in place since the 1960s and a partly institutionalised second economy appeared in the 1980s (Bruszt, 1995: 265). Kádárism was a variant of ‘perverse corporatism’, where special interest groups enjoyed priority over systemic maintenance (Bruszt, 1995: 272). The New Economic Mechanism

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endowed Hungary with a two-tier banking system, income taxes, corporate legislation and both IMF and World Bank memberships. The transformational shock was then comparably less acute.

The Hungarian transition experienced four periods: 1990-1994, the transformational recession and József Antall's symbolic politics; 1994-1998, stabilisation and consolidation, return to professional policymaking under the Socialist Party; 1998-2006, sustained growth accompanied by a deteriorating fiscal balance due to increasingly populist alternation between conservatives and socialists; and since mid-2006, the descent into political and economic crisis.

During the transformational recession, the Hungarian Democratic Forum introduced strict bankruptcy laws and attracted foreign capital, but it simultaneously postponed the majority of structural reforms and left public finances in dire straits. In 1994, public expenditure exceeded 60% of GDP and the twin deficits were close to 9% of GDP. Inflation and unemployment rose to double digits. The crisis worsened as PM Gyula Horn's newly appointed socialist-liberal government dragged its feet for the better part of the year.

By the end of 1994, devaluation and speculation expectations mounted, fuelled by the crisis in Mexico. In order to face the emergency, PM Horn appointed Finance Minister Lajos Bokros and the new Hungarian National Bank's (MNB) president György Surányi, the so-called 'dynamic duo'. Bokros launched his austerity package in March 1995. His neoliberal views put the new pension orthodoxy firmly onto the agenda, culminating in the 1997 reform.

Very soon stabilisation started to bear fruits through lower inflation and shrinking deficits. Privatisation of state-owned enterprises was almost complete by the end of term. A decade of sustained real GDP growth began in 1997.

The election of the Alliance of Young Democrats (Fidesz), which nurtured a vicious antipathy against anything enacted by the socialists, including the pension reform, started the fiscally irresponsible phase in Hungarian politics. Their pamphlet 'On the Threshold of a New Millennium' envisaged tax incentives and social contribution cuts that would generate economic growth of 7% of GDP *per annum*, without either aggravating the twin deficits or fuelling inflation (BBJ, 13-19 April 1998). Initially, Fidesz backtracked on this madness. The allegiance of its heavyweights to macroeconomic stability kept spending under control (BBJ, 20-26 July 1998).

In December 1999, however, a reshuffle weakened the incumbent coalition's liberal wing. György Matolcsy, the new Economic Minister, launched a Keynesian new deal called the 'Széchényi Plan' to counter the global economic slowdown. The two-year, purely electoral budget, doubled minimum wages and increased the salary of one fifth of total employees (BBJ, 4-10 December 2000; 23-29 April 2001; BBJ, 31 January - 6 February 2000, 1-7 October 2001). Furthermore, the government tightened its grip on the economy through a wave of

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renationalisation and by strengthening the Ministry of Finance. The running of gargantuan projects off-budget that circumvented public procurement laws attracted major criticism and soured good relations with the international community (BBJ, 22-28 October 2001).

When the IMF rebuked the government for excessive spending, the Premier asserted that Hungary did not consider to borrow further from international financial institutions (BBJ, 4-10 June 2001). The World Bank started the graduation process in the run-up to EU accession and desisted from proposing further lending programs (World Bank, 2 April 2002). Consequently, the Bank ceased to play a significant role in Hungarian politics after 1998, which resulted in unaccomplished restructuring and little authority over deficit spending.

Unsurprisingly, the 2002 election witnessed the worst political budget cycle in Hungarian history. The victorious Socialist Party introduced the 13th pension and an immediate fifty percent hike in public sector salaries. Notwithstanding continuous warnings against lax fiscal policy, the spending spree engendered the spiralling rise of public and external debts, reversing the virtuous cycle that began in 1994. Rating agencies downgraded the country's credit worthiness and the European Commission started an excessive deficit procedure in July 2004. Hungary missed all but one Maastricht criteria and its Convergence Plan failed to even mention a date for Euro adoption (BBJ, 28 August - 3 September 2006).

During the 2006 elections, the socialist-liberal coalition prevailed once again. Premier Gyurcsány was finally able to renege on his promises and launch a mild austerity package. The economic situation was worse than reported, hence, the social contribution reductions scheduled for 2007-2009 were discontinued and the government signalled a strong commitment towards structural reforms. Notwithstanding, these stabilisation efforts came too late. A decade of mismanagement irremediably weakened Hungarian fiscal standing, which sent Gyurcsány in 2008 cap in hand to the IMF begging for funds, prompted his resignation less than a year later.

Political-institutional structures

After the 1990-1994 period of extraordinary politics, politics as usual marked the democratic and economic consolidation under the Hungarian Socialist Party. The party did not employ outright divisive tactics but it nonetheless tried to transform the inherited political capital into economic and electoral advantages, thereby nurturing its narrow constituencies. Among these, the party's pro-welfare faction mitigated the executive's unboundedness. After 1998, under the rule of Fidesz, even this disappeared, as the party openly resorted to *divide et impera* strategies. Hungary plunged into protracted democratic 'de-consolidation'. Institutional structures and ideology account for the political budget cycles and policy swings. On the one hand, peculiarities of the party and electoral systems exacerbated the political alternation

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between the centre-right and centre-left blocks. On the other hand, the New Right attempted to dismantle the existing political power structures and disrupt the socialist oligarchies that emerged after the 1989 National Roundtable Talks (Bozóki, 2008).

Institutions of government

The Hungarian Constitution is based on the Soviet-inspired 1949 document, which was amended in October 1989. Hungary was re-established as a parliamentary democracy with a weak presidency and a strong premiership, as shown in Table III.1.

A complex exchange between the Hungarian Socialist Workers' Party and the seven-party 'Opposition Roundtable' resulted in the introduction of a dual-ballot mixed-member electoral system, which guarantees stable majorities in the National Assembly (Kenneth and Schiemann, 2001). Such an electoral system converts narrow electoral margins into manufactured majorities, thereby configuring Hungary as a pluralitarian democracy (see Table III.2). After the founding elections, the incumbent Hungarian Democratic Forum and the largest opposition party Alliance of Free Democrats (SzDSz) agreed to implement the constructive vote of no confidence, an effective way to counterbalance the Parliament and strengthen the executive (Bozóki, 1992: 69-70).

Amid this dictatorship of the majority, the Constitutional Court played a moderating role. Stark and Bruszt (1998: 170-171) enumerate the instances when the Court contrasted governmental unilateralism. Once the Socialist Party took office in 1994, the tribunal intervened against the Bokros package and other austerity measures. As a consequence of the Court's tough stance, PM Horn became extremely cautious and forced the executive to act pre-emptively and withdraw suspicious laws.

Despite the potential to do so, the premiers before Viktor Orbán did not exasperate this institutional setting. The leader of Fidesz instead promised *"less than a change in the system, more than a change in government"*, aiming to create a Westminster-style two-party democracy where the winner takes all. The Prime Minister's office was strengthened and assigned to a separate ministry, the parliamentary schedule overhauled, question times limited, and the parliament's controlling role downplayed by ignoring all hearing committees proposed by the opposition (BBJ, 15-21 October 2001). Even though Orbán's attempt was unsuccessful, he transformed Hungarian politics into an adversarial, polarised system, which is permanently involved in a civil cold war.

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Table III.1 Political institutions in Hungary

Separation of power political arenas	Actors	Rules of investiture/dissolution	Rules of decision-making
Executive	President	5-year term, renewable once; elected by the majority of two-thirds of Members of Parliament in first two rounds and simple majority in the third round; can be impeached for any violation of the Constitution.	Largely ceremonial duties; initiates legislation; promulgates laws and can return a law to Parliament for reconsideration; proposes the Prime Minister for election in Parliament; appoints and relieves the Ministers of their duty, on recommendation of the Prime Minister.
	Prime Minister	The Parliament elects by simple majority the Prime Minister and simultaneously accepts the government program; is held accountable by the Parliament through a constructive vote of no confidence.	Right to issue decrees and pass resolutions, introduce and propose legislation; proposes the state budget; ensures the implementation of laws.
Legislative	National Assembly (Országgyűlés)	4-year term, 386 members; dual-ballot mixed-member electoral system; the majority of its members dissolve the Parliament to call early elections; the President dissolves the Parliament if a motion of no confidence is passed four times during 12 months; and if a new Prime Minister is not instated in 40 days after the executive's mandate ends.	Two readings; the extraordinary procedure needs the agreement of four fifths of present Members of Parliament.
Judiciary	Constitutional Court (Magyar Köztársaság Alkotmánybírósága)	9-year term, renewable once; 11 judges elected by the majority of two-thirds of Members of Parliament; elects the President and Vice-president for a 3-year term.	Judicial review rights; wide competences; decides on the impeachment of the President.
Electoral	Referendum	Compulsory for the accession of Hungary to the EU; called mandatorily if initiated by 200,000 voters; may be called by Parliament if initiated by President, government, one third of Members of Parliament and 100,000 voters.	Majority of votes and at least one fourth of voters.
Territorial units	20 regions: 19 counties (megyék) and 1 city (főváros): Budapest	23 towns + Budapest have county's rights. 4-year term; elections and local referendum.	Local authorities have extended powers (they issue decrees) but they are not independent territorial units.

Source: Hungarian Constitution.

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Table III.2 Electoral system in Hungary

Year	Seats	Method for allocating seats
1990 1994 1998 2002 2006	386 of which	Dual-ballot mixed-member (two votes cast in each round). The thresholds for PR and compensation seats are 5% for single parties, 10% for coalitions of two parties and 15% for three or more.
	176 majoritarian in single-seat constituencies	- First round: if voter turnout is below 50%, all candidates to second round if voter turnout is over 50% and a candidate gets 50% of the vote, there is no second round if voter turnout is over 50% and no candidate gets 50% of the vote, the first 3 candidates go to the second round, plus all those with more than 15% of the vote - Second round: if voter turnout is below 25%, or two candidates get the equal votes, the seat remains vacant otherwise relative majority of voters
	152 proportional in regional/county and capital constituencies on lists	- First round: if voter turnout is below 50%, all candidates to second round if voter turnout is over 50%, PR with thresholds and d'Hondt conversion method - Second round: if voter turnout is below 25%, the seats are added to compensation seats otherwise PR with thresholds and d'Hondt conversion method
	58 compensation seats for vacant seats	- Parties that passed the threshold are entitled. The sum of votes cast in regional constituencies and the sum of votes cast for the candidates who lost on single-seat constituencies are counted.

Source: Act XXXIV of 1989.

Elections and parties

After the return of the Hungarian Socialist Party in 1994, Hungary became the closest example of a two-party system in Central, Eastern and Southeastern Europe. Instead of generating stability, this configuration augmented the aggressiveness of political competition to the extent that policy continuity and political consensus are virtually unattainable. Adding to the problem is the involution of Fidesz from liberal to nationalist and populist. Failed acceptance of the New Right of basic democratic rules implies that electoral competition in Hungary is not only about executive power, but also the system's political-institutional configuration. Table III.3 and Table III.4 provide a summary of Hungarian parties and an overview of its executives.

During the first years of symbolic politics, the Hungarian Democratic Forum completed the transition but created pain and deepened the cleavage between a Christian-national-conservative right and a rising anti-fascist pro-European left. The Socialist Party committed itself to market reforms and political pluralism, seizing power already in May 1994.

Under the leadership of Premier Gyula Horn, MSzP obtained an absolute majority of parliamentary seats. It formed a coalition with the Alliance of Free Democrats (SzDSz) to appease public concerns over the return of the Left and gain a two-thirds majority in Parliament.

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The socialists returned to professional policymaking and, starting with the Bokros package, embarked on a pro-Western, neo-liberal agenda.[17] Even though the strategy bore its fruits, this did not prevent the Alliance of Young Democrats from winning the 1998 elections. Understandably, MSzP was not punished for its pro-liberal economic views, but for the scandals and internal corruption that gave Fidesz, which portrayed itself as a clean party untainted by government, an enormous advantage (BBJ, 1-7 December 1997, 1-7 June 1998).

With the ascendance of Viktor Orbán (and later of his leftist counterpart Ferenc Gyurcsány) the personalisation of Hungarian politics started. During government, Fidesz completed the metamorphosis from a libertarian, anticommunist party to a nationalist, conservative one. Orbán's attempt to unify the domestic right proved, however, fatal. In addition to strengthening his grip over state and economic institutions, the party never stopped fishing for the extremist votes of the openly anti-Semitic Hungarian Justice and Life Party (MIÉP). Consequently, the party's rhetoric became increasingly nationalist.

Fidesz accused socialists of treason for abandoning ethnic Hungarians abroad and for being allies of Big Business (BBJ, 4-10 March 2002, 15-21 April 2002). The uncertainty surrounding the 2002 elections exacerbated the two coalitions' populism and reciprocal scorn. The socialists adopted an aggressive electoral strategy and the two parties' electoral manifestos were equally populist.

Notwithstanding that MSzP was deeply divided, voters turned their backs on PM Orbán: his government lacked transparency, nurtured nepotism and indulged in shameless propaganda. The socialist candidate and former Finance Minister Péter Medgyessy identified the electorate's fear that Fidesz would have to ally with the xenophobic right to govern over a split country (BBJ, 15-21 April 2002).

Initially it was assumed that the socialists, who promised a glass-pocketed budget, would renege on costly promises. However, less than one month in office, a scandal involving the premier broke out and coalition partner SzDSz shortly withdrew its support (BBJ, 24-30 June 2002). In order to regain some popularity, Medgyessy kept most electoral commitments. The political result was spectacular: pollster Szonda Ipsos proclaimed him the most popular politician in Hungary, the first time for a serving premier. However, the consequences were dear and the government was held responsible.

Instead of deflecting the blame for poor economic performance and strengthening MSzP's liberal wing, continuous cabinet reshuffles increased factionalism and lowered

[17] MSzP is divided into three ideological platforms: the 'social-democratic' anti-nationalist and pro-liberal faction; the 'leftist' anti-nationalist and anti-liberal group; and the 'socialist' pro-nationalist and anti-liberal bloc (BBJ, 23-29 April 2001).

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credibility. Following Medgyessy's pre-emptive resignation, Ferenc Gyurcsány, a Hungarian businessman and a liberal, was appointed Prime Minister in September 2004. The timing was bad: at midterm no structural reforms could enter the agenda. The 2006 election was a smaller-scale replication of the previous competition between MSzP and Fidesz, with the difference that the Hungarian Democratic Forum firmly demanded its coalition partner to jettison some excessively populist claims. MDF's leader Ibolya Dávid claimed that a right-wing party cannot be against capital, private ownership, banks and that it should not flirt with extremists. She effectively condemned Fidesz to defeat (BBJ, 17-23 April 2006).

Ferenc Gyurcsány became Hungary's first post-1989 Premier to serve two consecutive terms. Yet the honeymoon with the electorate was extremely short-lived. In an address to party members in May 2006, Gyurcsány admitted how the government lied 'morning, noon and night', which helped him to secure an unexpected second mandate (BBJ, 25 September - 1 October 2006). The speech leaked out to the public and triggered violent protest in Budapest. This left a very strong institutional position in the hands of a politically very weak premier, who had to resign during 2009. Given the deep economic and credibility crisis, it is now very unlikely that badly needed restructuring may be carried through (Csaba, interview).

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Table III.3 Party system in Hungary (parties ever represented in Parliament)

Party family affiliation	Acronym	Party name	Ideological orientation	Establishment and merger details	Foundation
Right	MIÉP	Hungarian Justice and Life Party (*Magyar Igazság és Élet Pártja*)	Radical nationalist	In 2005 it joined the MIÉP–Jobbik Third Way Alliance of Parties (*MIÉP–Jobbik a Harmadik Út pártszövetség*) and recently split.	1993
	Fidesz	Fidesz – Hungarian Civic Union (*Fidesz – Magyar Polgári Szövetség*)	Conservative, Christian democratic	It was founded as Fidesz, Alliance of Young Democrats (*Fiatal Demokraták Szövetsége*) as a libertarian, anti-communist party. In mid-1990s the conservative turn. It became in 1995 Fidesz – Hungarian Civic Union.	1988
	KDNP	Christian Democratic People's Party (*Kereszténydemokrata Néppárt*)	Christian democratic	It ran on Fidesz lists in 2006.	1944, banned in 1949, re-established 1989
	MDF	Hungarian Democratic Forum (*Magyar Demokrata Fórum*)	Liberal conservative, Christian democratic	It ran on Fidesz lists in 2002.	1987
Centre	FKgP	Independent Smallholders, Agrarian Workers and Civic Party (Független Kisgazda, Földmunkás és Polgári Párt)	Agrarian populist		1908, banned in 1949, re-established in 1988
	SzDSz	Alliance of Free Democrats – the Hungarian Liberal Party (*Szabad Demokraták Szövetsége – a Magyar Liberális Párt*)	Liberal		1988
Left	MSzP	Hungarian Socialist Party (*Magyar Szocialista Párt*)	Social democratic	Successor of the Hungarian Socialist Workers' Party (*MSzMP - Magyar Szocialista Munkáspárt*).	1989

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Table III.4 Hungarian executives

Date of change in political configuration	Presidential investiture	President (party)	Election date	Start of government	Head of government (party)	Governing parties (seats)	Government majority (% seats)	Government electoral base (% votes)
03.05.1990			25.03.1990	03.05.1990	József Antall (MDF)	MDF (164), FKgP (44), KDNP (21)	59.3%	42.9%
	04.08.1990	Árpád Göncz (SzDSz)						
12.12.1993				12.12.1993	Péter Boross (MDF)	MDF (164), FKgP (44), KDNP (21)	59.3%	42.9%
15.07.1994			08.05.1994	15.07.1994	Gyula Horn (MSzP)	MSzP (209), SzDSz (69)	72.0%	52.7%
06.07.1998			10.05.1998	06.07.1998	Viktor Orbán (Fidesz)	Fidesz (113), Fidesz-MDF (50), FKgP (48), MDF (2)	55.2%	42.6%
	04.08.2000	Ferenc Mádl (independent)						
27.05.2002			07.04.2002	27.05.2002	Péter Medgyessy (MSzP)	MSzP (178), SzDSz (19), MSzP-SzDSz (1)	51.3%	47.6%
29.09.2004				29.09.2004	Ferenc Gyurcsány I (MSzP)	MSzP, SzDSz		
	05.08.2005	László Sólyom (independent)						
09.06.2006			23.04.2006	09.06.2006	Ferenc Gyurcsány II (MSzP)	MSzP (186), SzDSz until 01.05.2008 (18), MSzP-SzDSz (6)	54.4%	49.7%

Source: National Election Office (www.valasztas.hu).

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Interest groups

Having one of the region's most concentrated authorities, the institutionalisation of social dialogue or interest group representation played an instrumental role in Hungarian politics. Under the Socialist Party, policymakers indulged in clientelism only for short-term vote-seeking goals. Under Fidesz, they resorted to antagonistic and divisive decision-making that sidelined all electorally uninteresting constituencies. The socialists selectively targeted two groups of elite welfare stakeholders during the 1997 pension reform: trade unions, especially the successor National Association of Hungarian Trade Unions (MSzOSz), which effectively controlled the Pension Insurance Fund, and the rising financial service lobby, through the voluntary mutual benefit funds and their Supervisory Authority.

As shown in Table III.5, the Hungarian corporatist arena is very weak: union density was less than 17% in 2004. The six confederations, among which MSzOSz is the key representative, are divided along the pro- versus anti-communist cleavage. PM Antall's divisive politics further exacerbated their antagonism (Avdagić, 2005: 38). An attempt at unification failed in 2000. Meanwhile, membership, financial resources and skilled staff are declining.

Table III.5 Trade unions and membership (2003)

Trade Unions' Co-operation Forum (*Szakszervezetek Együttműködési Fóruma*)	SzEF	270,000
National Association of Hungarian Trade Unions (*Magyar Szakszervezetek Országos Szövetsége*)	MSzOSz	240,000
Alliance of Autonomous Trade Unions Confederation (*Autonóm Szakszervezetek Szövetsége*)	ASzSz	120,000
Democratic League of Free Trade Unions (*Független Szakszervezetek Demokratikus Ligája*)	LIGA	100,000
Confederation of Unions of Professionals (*Értelmiségi Szakszervezeti Tömörüles*)	ÉSZT	85,000
National Federation of Works Councils (*Munkástanácsok Országos Szövetsége*)	MOSz	56,000

Source: European Commission (2008a: 266).

Hungarian tripartism, embodied in the National Interest Reconciliation Council (OÉT) and its successors, is in a sorry state as well (Ost, 2000: 509-511). During the 1990s, both conservative and socialist governments systematically sidelined the Council, which became an informal consultative body that legitimised official policies.

With respect to social security, Antall's government reformed the National Insurance Institution. In January 1989, the Social Insurance Fund was separated from the central budget. From 1991 it was given its own resources and administration, and a self-governing board to let both contributors and beneficiaries participate, in line with its pre-war predecessor. The Fund was definitely eliminated in 1992 and split into the Health and Pension Insurance Funds (OEP and ONyF). The self-governing experience was disastrous. MSzOSz won a landslide at the May

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1993 elections for the two boards and got entrenched in mismanagement, cronyism and innumerable scandals. Gyula Horn's executive started courting MSzOSz and ONyF just before the electoral period: the MSzP's socialist wing was deeply ensconced in the union and had to be won over after four years of neoliberalism.

After 1998 it was all over. Fidesz adopted an openly confrontational stance towards organised labour. Relations soured to the extent that MSzOSz president László Sándor called the new Labour Code a *"110-year step backwards in the history of worker's rights in Hungary"* (BBJ, 23-29 April 2001). Negotiations were discontinued and the Reconciliation Council dismantled. The newly established National Labour Council's task was to check the compliance of Hungarian labour legislation with the *acquis communautaire* (BBJ, 31 May - 6 June 1999). In reality, the institution was consulted only for the Labour Code. Other legislation directly concerning labour (social security included) was simply rammed through. On top of that, Fidesz eliminated the self-governing character of the Pension and Health Insurance Funds, thereby depriving the social partners of any influence. Since MSzP returned to power, government-labour relations improved, yet inherent problems of trade union weakness were not tackled.

As for other interest groups, a Hungarian peculiarity was the activity of the financial service lobby prior to pension reforms. The introduction in 1993 of supplementary pension schemes empowered not only private providers, but also the Supervisory Authority of Voluntary Mutual Benefit Funds. The introduction of further funded elements during the 1997 reform elicited an effective lobbying effort, as a result of which Horn's government granted these constituencies very costly side-payments.

Pensions

After the Second World War and hyperinflation swept away interwar occupational funds, the People's Republic of Hungary extensively rebuilt social security. Szikra (2007: 10) distinguishes three periods of social security evolution during state socialism: 1940s-1950s, initial setup of the PAYG system; 1960s-1970s, development of social rights in the aftermath of the 1956 revolution and expansion of coverage to include agricultural workers; 1980s, full coverage and insurance of a wider set of risks.

Act II/1975 crystallised the pension system. Retirement age was set at 60 for men and 55 for women, the minimum pension and accrual rates were merged into a function of years in service and earnings. The pension base was calculated from the wages of the best three out of last five years in employment and the entry pension's net replacement was capped at 75% of the base with 42 years in service. By 1984, the Council of Ministers took over the National

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Insurance Institution, founded in 1928, freeing it from the conservative diehards in the Central Council of Trade Unions (Szikra, 2007: 16).

The reason for doing so lay in the need to find swifter responses to face the deteriorating economic situation. The public scheme's unsustainable generosity was an open secret even under socialism (Augusztinovics, 1993: 309-312; Ferge, 1999: 231). As a result, benefit cuts started almost a decade before transition.

The part of Proposition 1 stating that restructuring is seriously considered only when simple corrective measures cease to be effective, holds only to a degree in Hungary. Rather than exhausting the possibility to refinance and retrench the system, the crisis and its immediate clumsy responses simply increased its unintelligibility. Systemic reforms, which contemplated elements of the new pension orthodoxy, entered the agenda due to the rise of Hungarian neoliberals in the early transition. What instead holds is that negotiated bargains involving complex trade-offs were necessary to find an agreement with those party factions that opposed the neoliberal current.

Crisis

Pension expenditures almost trebled between 1970 and 1994. Notwithstanding, pension spending on GDP was the lowest among the four case studies, due to covert retrenchment measures during the 1980s. Entry pensions were made step-wise degressive, with successive income brackets contributing less than proportionally to the entry benefit. These same brackets were not indexed, steadily worsening entry pensions for middle- and high-income employees. Insufficient compensation eroded continuing pensions, flattened the distribution of income and aggravated old-age poverty. Only the lowest pensions maintained their value (Máté, 2004: 120).

The transformational recession precipitated the crisis, as shown in Table III.6 and Table III.7. One third of existing employment vanished: 10% exited the labour market, 10% became unemployed and 10% veritably entered the grey economy (Simonovits, 2008: 73-74). Consequently, the number of contributors dramatically decreased with respect to pensioners, especially the disabled. The System Dependency Ratio deteriorated until 1999 and ceased to reflect Hungary's age structure altogether.

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Table III.6 Hungarian pension crisis characteristics

	Pension expenditure /GDP	Pension revenues /GDP	Pension balance /GDP	Number of pensioners	Number of insured	Contribution rate	Replacement rate
Effect	**Stable at 8% of GDP (ONyF only) in early transition, peaked in 1994 at 10.4%, fell to 7.3% by 1997.**	**Constantly decreasing.**	**Slight deficits in the range of 0.2-0.5% of GDP. Surplus of 0.1% in 1997.**	**Increased by 21% during 1990-1998.**	**Fell by almost 25% in 1990-1998.**	**Stable at 37.5% (all contributions) and 26.5% (pensions) of gross wages, standardised.**	**Declined to 57.7% and crept back after 1997. Real pensions decreased almost 30% in 1989-1997.**
Cause	Lengthier base, *ad hoc* indexation, inflationary savings kept costs at bay.	State-owned enterprises' arrears, ceiling to employee contributions, underreporting self-employed and worsening SDR.	Lower expenditures matched contribution erosion.	Early retirement accounts for 13% rise in old-age, lax eligibility for 43.3% in disability pensions	Inactivity, unemployment and grey economy.	A coherent contributory structure for pensions and healthcare was created in 1992.	Insufficient indexation and other retrenchment measures.

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Table III.7 Economic and pension system indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Pension outlays as % of GDP[1]	-	-	-	-	-	9.42	8.76	8.58	9.03	9.05	8.42	8.64	9.19	9.14	9.29	9.78	10.01	10.40
SDR – Insured to pensioners	1.99	-	-	-	-	1.41	1.33	1.25	1.24	1.20	1.22	1.23	1.24	1.26	1.26	1.27	1.28	1.28
SDR – Pensioners to insured	0.50	-	-	-	-	0.71	0.75	0.80	0.81	0.83	0.82	0.81	0.81	0.79	0.79	0.79	0.78	0.78
Age Dependency Ratio (+65/15-64)	20.1	20.3	20.5	20.6	20.7	20.8	21.0	21.1	21.3	21.4	21.6	21.7	21.7	21.8	21.9	22.0	22.2	-
Net replacement rate	-	-	60.6	60.3	59.3	61.9	59.2	56.9	59.8	61.8	62.0	62.0	60.3	60.2	63.8	65.1	66.5	69.5
Insured[2]	5,146	-	-	-	-	4,232	4,080	3,889	3,886	3,818	3,843	3,836	3,845	3,900	3,879	3,881	3,908	3,904
o/w in 2nd pillar									1,339	2,021	2,280	2,251	2,192	2,304	2,403	2,511	2,655	2,661
o/w opted out									6.8	11.1	20.8	18.6	51.3	11.5	1.5	2.4	2.8	7.7
Beneficiaries[3]	2,587	2,668	2,795	2,868	2,948	3,010	3,059	3,104	3,139	3,184	3,145	3,116	3,103	3,093	3,068	3,063	3,053	3,045
o/w old age	1,462	1,516	1,542	1,564	1,589	1,600	1,621	1,647	1,652	1,665	1,671	1,668	1,664	1,657	1,638	1,643	1,658	1,676
o/w disability	543	575	631	659	690	718	745	767	778	759	763	772	790	800	807	808	806	803

Unemployment	1.4	8.2	9.3	11.9	10.7	10.2	9.9	8.7	7.8	7.0	6.4	5.7	5.8	5.9	6.1	7.2	7.5	7.4
GDP growth	-3.5	-11.9	-3.1	-0.6	2.9	1.5	1.3	4.6	4.8	4.2	5.2	4.1	4.1	4.2	4.8	4.0	4.1	1.1
Inflation	28.9	35.0	23.0	22.5	18.8	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.3	4.7	6.8	3.6	3.9	8.0
Wage growth	27.2	33.4	24.3	21.9	22.6	16.8	20.4	22.3	18.3	13.9	13.5	18.2	18.3	12.0	6.1	8.8	8.2	8.0
Budget balance	0.0	-2.9	-6.1	-6.0	-7.5	-6.7	-4.7	-6.2	-8.2	-5.5	-2.9	-4.0	-9.0	-7.2	-6.4	-7.8	-9.3	-5.5
Public expenditure	56.6	56.4	60.2	60.2	59.5	52.6	52.6	52.2	52.8	49.9	46.5	47.3	51.4	49.1	48.9	50.1	51.8	50.0
Public debt	-	74.6	79.0	90.4	86.0	87.4	73.7	64.0	62.0	61.1	54.2	52.1	55.8	58.1	59.4	61.7	65.6	65.8
C/A balance	0.4	0.8	0.9	-9.0	-9.4	-3.7	-4.0	-4.5	-7.2	-7.8	-8.4	-6.0	-7.0	-7.9	-8.6	-7.6	-7.5	-6.4
External debt	56.1	62.9	61.8	66.8	66.5	72.1	63.7	55.6	56.3	65.2	63.2	63.7	55.5	63.8	69.4	78.0	92.5	98.9

Source: Hungarian Central Statistical Office (KSH), Hungarian Financial Supervisory Authority (PSzÁF), Pension Insurance Fund (ONyF). ADR: HNPStats (World Bank). Economic indicators: European Bank for Reconstruction and Development (EBRD) (http://www.ebrd.com/country/sector/econo/stats/sei.xls). [1]Both social insurance funds. [2]It includes employees, self-employed, entrepreneurs and persons receiving unemployment benefits. [3]Beneficiaries financed by ONyF, OEP and other funds.

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Early responses

PM Antall's government did not have a clear plan to solve the impasse (Müller, 1999: 63-70). The legislative jumble consisted of refinancing measures, retrenchment and organisational changes, and it additionally established the voluntary funded pillar. None of these amendments prevented the situation from further deteriorating.

With respect to refinancing, conspicuous public assets were promised to enhance ONyF's budgetary autonomy, without yielding significant results. More effectively, a coherent contributory structure was created by 1992, as shown in Table III.8. Contribution rates varied before 1998, depending on the salary and type of activity. In 1988-1989, standardised contributions were fixed at 10% and employer ones at 43% of the entire wage, i.e. 37.5% standardised to gross wages, and separated for pensions and health (cf. Augusztinovics, 1993: 314). The contribution base was gradually expanded to honoraria and other earnings.

Table III.8 Old-age pension contributions 1989-2007

		1989[1]	1990[1]	1991[1]	1992	1993	1994	1995	1996	1997		
Employer		43	43	43	24.5	24.5	24.5	24.5	24.5	24		
Employee		10	10	10	6	6	6	6	6	6		
Total		53	53	53	30.5	30.5	30.5	30.5	30.5	30		
Ceiling (HUF/day)[2]		-	-	-	2,500	2,500	2,500	2,500	2,500	3,300		
		1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Employer		24	23	22	20	18	18	18	18	18	21	24
Employee	**PAYG only**	7	8	8	8	8	8.5	8.5	8.5	8.5	8.5	9.5
Employee	**PAYG**	1	2	2	2	2	1.5	0.5	0.5	0.5	0.5	1.5
	MPF	6	6	6	6	6	7	8	8	8	8	8
Total		31	31	30	28	26	26.5	26.5	26.5	26.5	28.5	33.5
Ceiling (HUF/day)[2]		4,290	5,080	5,520	6,020	6,490	10,700	14,500	16,440	17,330	18,490	19,500

Source: ONyF. MPF – Mandatory Pension Funds. [1]Until the establishment of ONyF, contributions flowed into the Social Insurance Fund and included the health insurance part. [2]The contributory ceiling applies to employees only.

Changes in benefits and eligibility were attempts at retrenchment. The assessment base was gradually elongated to the whole career, starting with 1988 wages. Other measures generated substantial inflationary savings at a time of high inflation and real wage contraction (Table III.7): valorisation of past earnings was truncated for the last three years before retirement, forward-looking indexation to net wages became backward-looking, income counting towards pension calculation was capped and this ceiling held nominally constant. These measures skewed the distribution of pension benefits. Those who retired between 1986 and 1990 earned on average 20-25% higher pensions than those retiring between 1992 and 1995. The pensionable age was gradually increased to 62 for all, taking full effect in 2009. As early as in

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1982, the minimum vesting period increased from ten to twenty years over the following decade (Augusztinovics et al., 2002: 30-34; Máté, 2004: 116-121).

As mentioned before, organisational changes were substantial. The National Insurance Institution was separated from the budget, transformed into the Social Insurance Fund and split into the Pension and Health Insurance Funds (ONyF and OEP). These underwent some profile clearance, which entailed the separation of healthcare from pension-related expenditures.

Finally, the introduction of voluntary schemes was a compromised solution to an ill-fated multipillar reform proposed by Parliament in 1991 (Gál, 2006: 187). Policymakers did not tackle the fiscal problems of the PAYG system, but at the same time paid lip service to capital market development through institutional investment (Müller, 1999: 68-70; Orenstein, 2000: 32). Despite generous tax deductions, which Simonovits (2009) labels as a perverse redistribution from poor to rich that costs 0.3% of GDP *per annum*, voluntary funds only trivially affect the public-private mix in Hungarian pension provision.

The voluntary pillar has a governance structure that reflects the pre-war mutual saving principle. This reprisal is explained by the lack of experience with modern corporate governance and its affinity with the self-reliance ethos as bulwark against unfettered capitalism. PM Antall's government advocated a self-helped mutualist structure to deny multinational companies another foothold in the economy. Consequently, naïve policymakers exhumed Hungarian pre-war trust law, which regulated genuine occupational schemes with boards of trustees who were responsible for governance. Neither concept proved compatible with the management practice of modern financial service providers. However, according to sociologist György Németh (BBJ, 4-24 August 1997), the problem lay not so much in the funds lagging a century behind contemporary corporate governance, but in the institutions' exclusivity; as if the government had closed down all banks and only let savings cooperatives operate.

Reaction

The reaction to restrictive measures in Hungary was relatively more timid than elsewhere. Notwithstanding, the Constitutional Court dealt heavy blows to the Bokros austerity package, by arguing that the preconditions of economic transition, which justify the modification of established rights, were absent in 1995 (BBJ, 27 November - 3 December 1995). Even though this signalled that retrenchment was not a viable course of action for the Socialist Party, Proposition 1 only partially applies to Hungary. Rather than the pension system crisis, the appointment of Finance Minister Bokros led to a serious debate on pension restructuring. The radicalism of Bokros, who advocated a Chilean solution, shattered the early consensus against

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privatisation and elicited a number of alternative proposals to reform the ailing public retirement scheme (Müller, 1999: 72-73).

Restructuring

Existing literature emphasises deep disagreement over the basic design of the Hungarian pension system (Müller, 1999: 75; Orenstein, 2000: 35-36; Iwasaki and Sato, 2008: 90). Two camps emerge. The Finance Ministers Bokros (who resigned in February 1996) and Péter Medgyessy, financially and ideologically backed by the World Bank, advocated structural reforms and initially even full, substitutive privatisation. The Ministry of Welfare and the Pension Insurance Fund's self-government instead elaborated a series of proposals within the Bismarckian-Beveridgean paradigm (cf. Augusztinovics and Martos, 1997).

Given these irreconcilable positions, finding a complex bargained solution became necessary, as suggested in Proposition 1. Medgyessy's resolve to draft a proposal together with the Ministry of Welfare bore its fruits and, after a number of concessions, the government endorsed the joint framework in May 1996. After that it took another painstaking year to propose a legislative draft. In order to convince the pro-welfare coalition, the bargains involved the trading against each other of all policy and political dimensions present in the Natali-Rhodes framework.

The complex debate on the future of Hungarian pensions took place in three different fora (for the most detailed account, see Orenstein, 2000). Legislation proper started with the establishment of a 30-member inter-ministerial working group, financed and assisted by the World Bank. Negotiations with the Pension Insurance Fund and the successor trade union MSzOSz took place in the Interest Reconciliation Council. Although its functions had been reduced to pre-legislative consultation, its approval was a precondition for pension reforms. Opposition to the package signed by Finance Minister Medgyessy and reformist Welfare Minister Mihály Kökény was substantial. MSzOSZ's leader, László Sándor, threatened a strike and former MSzOSz head Sándor Nagy organised a conference to criticise the proposal. The union won a significant number of concessions through the Interest Reconciliation Council. As for the coalition partner, SzDSz, the preferred debate forum was not the Parliament, but a special parliamentary group, i.e. the Coalition Parties Working Group on General Government Reform. After voicing doubts over restructuring, owing also to conservative members such as Nagy and former socialist Welfare Minister Judit Ceshak, the group reached a compromise and endorsed the joint proposal.

On 28 May 1997, four pension reform draft laws replacing Act II/1975 were submitted to parliament: Act LXXX/1997 on eligibility and contributions to social security and private

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pensions; Act LXXXI/1997 on social security pensions; Act LXXXII/1997 on private pension and private pension funds; Act LXXXIII/1997 on mandatory health insurance. They became law on 15 July 1997, after only six weeks of debate, and took effect in January 1998, granting less than six months to set the schemes up.

Policy trade-offs

Two decades of incoherent amendments reduced the Hungarian retirement system to: *"an almost impenetrable mix of social assistance (solidarity through redistribution) and social insurance (partial but fair replacement of previous income, based on contributions)."* (Augusztinovics et al., 2002: 33). In addition to the system's unintelligibility, worsening demographic projections and falling revenues threatened to generate fiscal deficits of 6% of GDP by 2050 (Holzmann and Guven, 2008: 111-113).

Finance Minister Bokros and his working group chaired by Ádám Gere, an investment banker with interests in the pension funds business, planned an all-out assault on the pension system through substitutive privatisation. Despite alleged improvements in systemic effectiveness, the manoeuvre was unsaleable in Hungary for fiscal reasons, owing to implicit pension liabilities amounting to 263% of GDP (World Bank, 1995: 36), and on equity grounds, as the pro-welfare coalition demanded numerous redistributive elements. Privatisation, however, did not slip off the agenda.

The World Bank's backing implied that advance funding, a three-pillar design and a lower contributory burden to boost competitiveness became firmly entrenched in the executive's plans. According to Proposition 2, the structural innovations present in a paradigmatic reform open up greater room for manoeuvre to policymakers. However, instead of employing them for their credit-claiming potential, Hungarian policymakers instrumentally used the reform's systemic elements to delegitimise the PAYG pillar. In order to build the demand for these innovations, the socialist-liberal government embraced the aversion to dependency culture and tried to discredit the public pension system in its public relations campaigns. The *leitmotiv* was a reinterpretation of equity as individual responsibility, as opposed to solidarism, which leads to dependency.

Both the Ministry of Welfare and the Pension Insurance Fund preferred more redistributive solutions and neither was, at least at the beginning, in favour of a mandatory funded pillar. With respect to the public PAYG pillar, the Welfare Ministry sought the cooperation of German advisors and advocated a point system, while ONyF supported a tax-financed basic pension to complement the existing PAYG arrangements. Both supported voluntary private solutions.

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Once a compromise to establish a three-pillar system was reached within government, there was still disagreement with the MSzOSz and ONyF. The long series of policy concessions included: a more generous benefit formula, delays in the introduction of Swiss indexation and disability pension reforms, the final downsizing of the funded pillar and more generous counting of service years for university studies and childrearing (Orenstein, 2000: 41-42). Early retirement channels introduced for employment policy reasons were closed down or severely limited, only to introduce numerous new venues right at the onset of implementation (Széman and Harsányi, 2008: 58-59)

These concessions, related to increased redistributive equity, contrasted not so much with the system's financial viability, but rather with the future possibility to decrease contribution rates, foregoing the objective of greater competitiveness. The Constitutional Court's aversion to unilateralism required extreme prudence from PM Horn (BBJ, 27 November - 3 December 1995). This resulted in poor second pillar legislation.

The mandatory cut-off age, above which participation to the private pillar is disallowed, was raised from 40 to 47 and later eliminated altogether. This decision called for collateral modifications. In order to discourage those close to retirement joining the funded pillar, annuities require a minimum accumulation period of fifteen years. Switching entails the renunciation to one fourth of accrued rights, increasing the cost of so-called active mistakes. A triple guarantee for private pillar participants was installed: inheritable assets in case of death, switching back in case of disability, and minimum benefits paid by a Guarantee Fund in case of poor performance (cf. Simonovits, 2009).

As for annuities, excessive concerns over discrimination between genders and between participants to the public and mixed systems resulted in the drafting of defective regulation. Differentiated mortality tables were discarded, creating adverse selection problems. Swiss indexation of annuities was preferred to indexation to prices, which shows the government's failure to understand defined-contribution schemes and gave insurers a hard time in forecasting (Impavido and Rocha, 2006: 39-42). Table III.9 summarises policy differences between proposal and output.

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Table III.9 Policy compromises

	Reform proposal	Reform output
First pillar		
Min vesting period	32-35 years for all	20 years for all
Contribution rate	15-18%	31%
Indexation	Swiss	Stepwise introduction until 2001
Second pillar		
Eligibility	Mandatory for those aged 47 and under	Mandatory for new labour market entrants
Contribution rate	10%	Stepwise increase from 6% to 8%
Guarantees	Privately-financed guarantee fund	State-backed minimum returns
Annuity indexation	Price	Swiss

Source: adapted from Orenstein (2000: 79).

In sum, the systemic reform introduced mandatory pension funds with the aim of augmenting the system's effectiveness, but imbued them with design flaws. It rendered the public pillar more equitable by gradually eliminating various degressive elements, but increased future regulatory uncertainty. It restored the system's projected fiscal balance, but ruined it afterwards (Gál, Iwasaki, and Széman, 2008: 145). Finally, it failed to alleviate the burden on the corporate sector or improve Hungarian economic competitiveness (Iwasaki and Sato, 2008: 90).

Political trade-offs

Since Hungarian policymakers made use of the multiple trade-offs envisaged in Natali-Rhodes' framework, it is crucial to comprehend whether these were constructively employed to build broad consensus around reforms, or, on the contrary, served the purpose of pushing the Hungarian Socialist Party's particularistic agenda. The assessment of Horn's policymaking style varies considerably. Orenstein (2000: 39) is positive: *"while pension reform in Hungary was indeed an expert or elite process, it was also a relatively open and democratic one of deliberation within a super-majority government coalition."* On the contrary, Ferge (1999: 237-238) writes that Hungarian reforms were top-down designed and imposed, an internal affair of the Socialist Party itself.

I agree with the latter view. Neither civil society, nor opposition parties significantly contributed to the shaping of policy. The former lacked adequate resources, which remained concentrated in the hands of the Ministry of Finance. The latter opposed the creation of a mandatory pillar, but avoided a constructive dialogue. Powerful elite welfare stakeholders, such as MSzOSz and the funds' lobby, deeply intertwined with parts of the state bureaucratic apparatus, secured costly economic privileges. Moreover, the government did not organise an adequate information campaign until July 1997. This resulted in general lack of awareness: according to pollster Szonda Ipsos, by May 1997, 45% of city dwellers had never heard of reforms and only 20% of those who did were conscious of their structural character.

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The analysis of public involvement is equally debasing (Kósa, 2002). Instead of an open renegotiation of the social contract, the government devoted five weeks to public debate, Christmas included, starting after the inter-ministerial working group finalised its proposal in December 1996. Concomitantly, the daily Népszabadság published a governmental note on the need to create the illusion of deliberation. Since there was no established procedure to process criticism, the government was simply not prepared to elaborate external feedback.

The public relations campaign was instrumental to increase the reform's legitimacy. It aimed to discredit state retirement provision by creating an asymmetric perception between the public and private pillars (Ferge, 1999: 239-240). Slogans, such as 'the old pension system retires', were not only self-contradictory, as three-quarters of the PAYG pillar remained in place, but they also fuelled popular distrust in public policy. The campaign was probably one of the cornerstones in building a 'negative consensus', which led to widespread rejection of the state as legitimate pension provider.

In practice, negotiations took place almost exclusively between MSzP's liberal wing and more leftist factions, frequently represented by the leadership of MSzOSz. The bargains involved trading policy and office concessions for the continuing electoral support of the party's socialist faction. Externally, neither the junior partner Alliance of Free Democrats nor the Fidesz-led opposition were sufficiently consulted. Whereas the Parliament discussed transition costs and the efficacy of pension funds, the side-payments to MSzOSz slipped through and elicited a wave of outrage. SzDSz opposed the handing over of the Health and Pension Insurance Funds' boards to the union and less than 60% of MPs voted for the reform package. Since only a minority within Fidesz supported the reform, the exclusion of the party from debate undermined policy stability after the following electoral round.

The influence of MSzOSz on reforms requires an explanation. In 1995, the appointment of the dynamic duo, Bokros and Surányi, was a victory of MSzP's liberal faction. Prominent leftists, such as Ministers Pál Kovács (welfare) and Béla Katona (national security), resigned in opposition to the Bokros package, unleashing an intra-party dispute. MSzP's socialist faction deplored the excessive power of the Finance Ministry and the drift of the Socialist Party away from traditional leftist values (BBJ, 27 November - 3 December 1995).

Paradoxically, the rekindled importance of MSzOSz during 1997 owes much to the success of the Bokros package. Before the economy started to improve, the popularity of MSzP slumped. Eventually the public began to appreciate the benefits of austerity and consequently PM Horn sensed that a second mandate was still within reach. As pension negotiations continued well into 1997, full support of the leftist wing became fundamental in view of the elections. MSzOSz was simultaneously present in the Pension Insurance Fund, in parliament with MSzP

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and as an autonomous interest group, so became the preferred negotiating partner for MSzP liberals.

In addition to policy concessions and various electoral promises to trade union leaders, MSzOSz saw its office-seeking goals fulfilled in May 1997. The two social insurance funds' inefficiency, scandals, deficits, and opposition to reforms that threatened their control over circa one-third of the budget were legendary. Notwithstanding, in June 1997 the Socialist Party rammed through Parliament a law that not only preserved the autonomous, self-governing structure of the boards for another two years, but also increased their 'undemocratic' autonomy. With the elimination of nationwide elections, trade unions and employer associations were allowed to directly appoint most of the board's 60 members (BBJ, 9-15 June 1997).

Both SzDSz and the opposition voted against the law. Several appeals to the Constitutional Court asserted that the nomination of unelected board members does not correctly represent the insured. Just before the elections, in May 1998, the Court ruled that both boards lacked the legitimacy and accountability required by Constitution (BBJ, 18-24 May 1998). The 2000 deadline to amend this gave the following, centre-right government the mandate to dismantle the social partner's control over social security.

Finally, various elite welfare stakeholders emerged in connection to voluntary pension schemes. Within the initially fragmented market, funds sponsored by financial institutions, as opposed to tiny employer-sponsored schemes, gathered the most members and assets (Matits, 2008: 117-119). These did not function as mutual funds any longer; they just implemented a for-profit business into a mutualist frame. Hence, the market did not develop homogeneously. Whereas larger financial institutions favoured demutualisation, the majority of voluntary funds saw in mutualism their *raison d'être*. The Supervisory Authority of Voluntary Mutual Benefit Funds developed a vested interest in keeping the mutualist corporate governance structure intact, in order to extend its influence over the mandatory funded pillar.

Representatives of the financial service industry sat in most deliberative fora. The choice between for-profit or non-profit corporate governance, and the organisation of contribution collection, elicited a considerable lobbying effort from both the funds and the regulator.

The proponents of a for-profit corporate structure claimed that it guaranteed greater transparency, comparability and professionalism. The opponents, e.g. György Radnai and Tibor Parniczky, respectively president and vice-president of the Supervisory Authority, preferred a non-profit approach, which fits Hungarian democratic values, prevents abuses by sales agents, and ensures competitiveness at asset management level through compulsory yearly tenders (BBJ, 30 September - 6 October 1996). Sociologist György Németh supported optional mutualisation (BBJ, 14-20 October 1996).

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Following the dispute, the inter-ministerial working group changed more than once the proposal drafts, to settle with a mandatory non-profit structure for all. The Hungarian Socialist Party exchanged inefficient policy to fulfil the Supervisory Authority's office-seeking aspirations, whereby the agency retained and reinforced its functions.

In addition to being uneconomical, this outcome casts doubts on the effectiveness of the World Bank's conditionality. After the dismal experience with the 1993 Pensions Administration and Health Insurance Project, concessions appeared acceptable and were supported by a governance structure that values the disbursement of a loan above its objectives. Since too many fires burned at the same time, the Bank underestimated the problems associated with a mutualist structure. Roberto Rocha gave in and demutualisation got shelved (Fehér, interview).

Nonetheless, the strength enjoyed by the Supervisory Authority did not last long. After seizing power, Fidesz unearthed the Socialist idea to unify financial market supervision under the aegis of the Ministry of Finance (BBJ, 15-21 February 1999). Three agencies merged into the Hungarian Financial Supervisory Authority (PSzÁF) by April 2000. The results are mixed. While staffing and financing are adequate, excessive government control is a cause for concern (Impavido and Rocha, 2006: 37-39). Both the cabinet and Parliament have the right to appoint top officials and this generates friction at leadership level. Additionally, the Supervisory Authority has little regulatory power. The Finance Ministry oversees most draft regulation, which is then issued by the Council of Ministers. Such procedure is again a source of interference and is only partially mitigated by PSzÁF resolutions, which *de facto* constitute a body of binding secondary regulation.

If supervision underwent a process of consolidation, the opposite was true for contribution collection. In order to hide contributions from the grabbing hand of the state, Hungary ended up with an over-bureaucratic, inefficiently decentralised solution (Párniczky, interview). Only in 2007 did the Tax Finance and Inspection Office, APEH, take over collection, finally transforming pension 'paper mills' into investment funds proper. Apart from generating considerable savings, the arrangement is still far from perfect. Taxpayers finance APEH's services, which is cost ineffective and generates unfair redistribution.

Reform outcomes

The four pension and health insurance laws entered into force in January 1998. The most notable change was the introduction of the second pillar, starting with a 6% contribution rate that had to increase to 8% during the following two years. Private insurance became mandatory for new labour market entrants in July 1998. The others could join until August 1999 and eventually switch back to the public scheme not later than September 2000. Other major changes included:

- Gradual increase in retirement age from 55/60 to 62 years for women/men (completed in 2009).
- Introduction of Swiss indexation during 1998-2001.
- Widening of the calculation period to average lifetime earnings, fully valorised at wage growth. Change from net to gross earnings in 2013. After that, pension benefits are taxed as personal income.
- Phasing out of degressive brackets for the calculation of the pension base. Their upper limits rise annually by 8% above net wage growth. Hence, the highest brackets become progressively void and all income eventually falls into the 100% bracket, so fully counting towards the pension benefit.
- Change in the PAYG benefit formula. Elimination of all degressive elements in 2013. Before, additional insurance years count less than proportionally towards the pension benefit. Participants to the mixed system receive 75% of the public benefit, effectively losing one fourth of past contributions. After 2013, calculation becomes linear: 1.65% per year for those who remain in the PAYG pillar only and 1.22% for those in the mixed system, i.e. 23/31 of the PAYG pillar, in line with the final repartition of contributions.

Table III.10 presents a summary of the new pension system.

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Table III.10 Multipillar system in Hungary

Pillar	Zero (non-contributory)			First (mandated, earnings-based)			Second (mandated, earnings-based)			Third (voluntary)		
Provision Financing Objective	Public	Tax-financed Means-tested Basic Benefit	Poverty alleviation	Public	PAYG Non-financial Defined Benefit	Insurance	Private	Financial Defined Contribution	Insurance	Private	Financial Defined Contribution	Insurance

	Benefit	Coverage	Eligibility	Benefit level	Indexation	Beneficiaries	Expenditures %GDP
Basic pension – Zero pillar	Old-age allowance	Persons above 62	Persons with income below 80% minimum old-age pension	Supplement actual income to reach 80% of minimum old-age pension	Based on minimum old-age pension	04% of population older then 62 (2003)	0.01

		Vesting period	Contribution rate	Contribution ceiling	Benefit rate	Assessment base	Retirement age	Indexation
Old-age pensions – First and second pillars	1st	15 years at 62, normally 20	TCR: 33.5% 24.0% employer 9.5% employee	Employee: set annually by government (circa 8x min wage) Employer: no max	Until 2013: degressive After 2013: linear	Wage-valorised lifetime earnings	62 for all in 2009	50% wages and 50% prices
	2nd	No min	PCR 8.0% employee		Depending on life expectancy and RoR	Accumulated funds		

	Vesting period	Retirement age	Tax treatment (contributions, returns, benefits)	Contributions tax deductible for employers	Lump sum payments possible
Supplementary pensions – Third pillar	10 years	No	Exempt Exempt Exempt 30% of contributions are deductible up to HUF 100 thousand Annuities are exempt after 20 years accumulation	Yes	Yes

Source: Holzmann and Guven (2008). PCR – Pillar-specific Contribution Rate. RoR – Rate of Return. TCR – Total Contribution Rate.

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Distributional consequences

Proposition 3 states that there are significant trade-offs between sound social policy and excessive emphasis on a pension system's financial viability. In the Hungarian case, this trade-off is less clear-cut than in the other three cases. Despite efforts by the Socialist Party to eliminate degressivity and increase effectiveness, the Hungarian pension system is inefficient and fiscally unviable. The PAYG pillar is still defined benefit, so fails to put in place the right incentives to work longer and save more. The funded pillars present technical and organisational flaws that seriously undermine their efficiency. The market lacks competitive pressure and has cartelisation tendencies. Mutualisation and decentralised contribution collection aggravate corporate governance defects. The inability to self-regulate drives operating costs up, prevents the appearance of economies of scale and reduces the overall performance below that of the PAYG pillar (Orbán and Palotai, 2005: 24-28). Finally, the limited and clientelistic bargaining involved in policymaking elicited, in line with Proposition 4, continuous costly and politically driven amendments. These had already destabilised the system's restored fiscal balance by 2001.

Public pillar adequacy

The Hungarian pension system (as a whole) is the most generous among the four case studies, as the projections by Holzmann and Guven (2008: 124-127) and Whitehouse (2007: 140) neatly show. Furthermore, continuous *ad hoc* increases in public pillar benefits (a lump sum in 2002, the 13th pension) pushed up current net replacement rates instead of depressing them, as shown in Table III.7. As a result, the retirement schemes' current capacity to replace income is not the most crucial issue.[18]

The main demerit of public pillar reforms is that they were not systemic and that several inadequate modifications were planned for 2013. Policymakers devoted so much energy to the private pillar, that the public one was not simplified by, for example, transforming it into a point system. Simonovits (2009) and Máté (2004: 139-141) posit that well-designed pensions should encourage compliance and delay retirement. The Hungarian system has yet to fulfil this task. Since a significant number of venues to early retirement have been left open, the effective retirement age hardly changed, despite efforts to the contrary.

More worryingly, Augusztinovics and Köllő (2009: 94-97) claim that the changes being phased in may significantly reduce redistribution and increase the risk of old-age poverty for workers with interrupted careers. Three solidarity components (15 years of service to qualify

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[18] For a diverging view, see Matits (2008: 120-121). She claims that Hungarian pensions are generous only for low-to-middle incomes, and that even this is not enough for a living.

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under unfavourable conditions, a minimum guarantee for entry pensions, degressive income brackets) are wound down and the degressive accrual factors with respect to the insurance period made constant in 2013. Whereas the system shall gain in transparency, the impact on lower entry benefits and on those not eligible due to short insurance periods could be dramatic.

Private pillar adequacy

As in the other cases, where public pensions were partially privatised, policymakers placed much faith in the capacity of the private pillars to supplant foregone benefits. The mandatory funds are, however, plagued by a whole series of problems, from excessive concentration to inadequate corporate governance and low returns. Each aspect is analysed separately.

Market developments

Due to the propaganda of both government and private funds, the funded schemes became instantly popular. Already in 1999, membership overshot the official forecasts (circa 1.5 million) by half a million, contributing to the number of active errors that may result in lower-than-expected benefits for incautious switchers (Orbán and Palotai, 2005: 12; Augusztinovics and Köllő, 2009: 95-96). According to Rocha and Vittas (2002: 11-12), the insured believed that the political risk of the PAYG scheme was higher than the funded system's market risk, in light of multiple manipulations during the 1980s and 1990s. After the initial hype, affiliation stagnated – mainly due to Fidesz's disinclination towards the funded pillar – and resumed only much later. In 2007, membership surpassed 2.7 million, roughly two thirds of the labour force, and the market managed assets worth almost 8% of GDP.

Of the 38 funds established initially, 18 survived and two entered the market in 2007. Of those 18, insurance companies sponsor six, banks founded four, big employers established five and three are independent. Table III.11 shows that the Big Six, all of which are insurance companies, apart from commercial bank OTP, garnered more than 80% of members and assets (cf. Allianz, 2007: 58).

Table III.11 The Big Six

	AEGON	Allianz Hungária	AXA	Évgyűrűk	ING	OTP	Big Six	Total
Membership								
31 Dec 2007	530,054	367,126	188,904	115,242	422,835	804,927	2,429,088	2,787,831
Share in %	19.0	13.2	6.8	4.1	15.2	28.9	87.1	100.0
Net assets HUF millions								
31 Dec 2007	346,003	209,521	155,396	73,129	349,771	517,143	1,650,964	1,979,360
Share in %	17.5	10.6	7.9	3.7	17.7	26.1	83.4	100.0

Source: PSzÁF.

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The Hungarian pension fund market is very segmented. Large funds, sponsored by the financial industry, survived and concentrated (Augusztinovics et al., 2002: 67-70). They aim to streamline administrative procedures, reduce costs and turn the business into mass production, possibly through demutualisation. Smaller funds are genuine mutual benefit associations and are thus lobbying for specific regulatory advantages. By the same token, funds linked to the financial sector want to stabilise the market, prevent poaching of members and keep marketing costs low. Quite to the contrary, the survival of smaller players is dependent on the preservation of their market niches.

This segmentation encouraged the largest funds to form a competition-limiting alliance. Furthermore, it delayed the emergence of a representative association of the funds and severely limited the industry's capacity to self-regulate. Powerful providers publicly announced and transparently established a cartel, which was openly endorsed by the Competition Office. In the fall of 1998, the four largest funds stipulated a competition-limiting agreement, ironically called 'ethics code', which hindered switching and restricted negative advertising (BBJ, 12-18 October 1998).

Most analysts, including the Competition Office's head Zoltán Nagy, condemned the 'ethics code' for curbing competition. The signatories of the pact provided two counterarguments. First, the agreement discourages but does not prevent members from voluntarily changing funds. Second, limiting unnecessary switching saves on marketing costs and so increases individual members' benefits (BBJ, 14-20 June 1999). This line of reasoning convinced the Competition Office to ignore its own investigators and bless the agreement (Hungarian Competition Office, 10 June 1999). The three-member court ruled that the pact breeches Competition Law, but that by reducing marketing costs it would be granted an exception. Instead of setting an example, the Competition Office let this go, contributing towards the funds' underwhelming performance. While the cartel survived antitrust censorship, internal defections destabilised it. Its dissolution might, however, unleash a major marketing campaign, possibly leading to further concentration.

In addition to this questionable agreement, in May 2000 the Big Six established the Hungarian Association of Pension Funds Stabilitás, to be represented at national and international levels. The association underwent gradual but constant expansion and consolidation. After signing a cooperation agreement with the Nationwide Association of Domestic Pension Funds, Stabilitás encompasses three quarters of mandatory funds and the majority of voluntary ones (BBJ, 5-11 June 2006).

The necessity to lobby arose out of a heavily regulated market with suffocating administrative requirements. In this respect, Stabilitás was relatively successful. In addition to

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the steady relaxation of investment limits, the association concluded an accord with the Tax Office in February 2007. When contribution collection was centralised in mid 2006, the larger funds convinced smaller players that only the standardisation of their communication procedures with APEH would ensure the operation's success. This led to a multilateral agreement among all Hungarian private pension funds first and, later, to a satisfactory compromise with the tax administration.

Notwithstanding these feats, Stabilitás failed to impose self-discipline on its members. For example, Aegon left the association after refusing to reduce its charges. The inability to exert some self-restraint and abate administrative costs resulted in the centralised setting of maximum fees by 2007. Such imposition does not lead to a long-term fee reduction, but rather to convergence to the upper limit, thereby fostering even more herding behaviour.

Corporate governance

In addition to cartelisation and limited self-regulation, mutualism and costly decentralised contribution collection lay at the core of the funded pillar's inadequacy. These indirectly overturned the two basic tenets of the new system: the nature of the mandate imposed on individual workers; and the self-managed character of governance (cf. Vittas, 1996: 24-25, 29).

The nature of the mandate is employer-based, leaving little choice to the insured (Augusztinovics, interview). A 2007 survey shows that 44% of those polled trust the employer or accountant in their choice of a pension fund and only a minority the sales agent (cf. Ágoston and Kovács, 2007). The pre-existing ties between enterprises and banks or insurance companies encourage employers to stipulate a single pension insurance contract for their entire workforce. By doing so, the firm avoids most costs related to decentralised collection, i.e. the disbursement of contributions to more than one fund and related paperwork (BBJ, 19-25 January 1998). An employer-based mandate curbs competition between funds, but has the advantage of reducing marketing costs.

More importantly, financial institutions circumvent the formal mutualist governance structure, as the sponsors *de facto* control their funds' boards. While there are good motives for doing so, the practical result falls short of sound business practice. On the positive side, to run a large pension fund requires a sponsor offering high operational standards, who is fully in charge of its business. On the negative side, the embedment of a for-profit logic into a mutualist frame lowers business transparency and emasculates competition (cf. Impavido and Rocha, 2006: 30-33).

That members own the pension fund and provide the capital is an acceptable governance structure for closed employer-based funds, but not for large institutional investors. Accounting is impossible to follow, since formally there are no investments or capital requirements. The sponsor bears no legal responsibility for the institution, neither for downside risks nor for operational fraud. The law stipulates and bookkeeping shows that these are non-profit organisations, but in reality they have a business plan and make a profit. Furthermore, mutualism encourages anticompetitive practice. Tenders to pick the asset manager, which should exert a downward pressure onto management fees, invariably lead to the selection of the financial group's internal candidate. Lack of comparability and weak disclosure requirements prevent members to 'vote with their feet' and migrate to funds applying lower fees. Finally, mutualism is also an effective barrier to entry, as a market for acquisitions cannot develop.

Performance

These problems have a negative impact on overall performance: Hungarian funds charge excessive administrative fees for underwhelming returns. Participation in the mixed system then became disadvantageous with respect to continued membership in the PAYG pillar, especially for older workers.

The funds' average annual net real rate of return was 2.1% during 1998-2004 (Orbán and Palotai, 2005: 12-13). The reasons for such poor performance were a wildly swinging Budapest Stock Exchange, excessive investment conservatism (see Table III.12), and disclosure requirements, which prompted herding behaviour and short-termism. After a brief period of high returns, in the first half of 2008 pension funds lost one tenth of their nominal capital and all of the semester's contributions. The recently established dynamic portfolios (with greater equity exposure) suffered the greatest losses during the subprime mortgage crisis.

Table III.12 Portfolio structure Q4 2007

Asset class	Amount (billion HUF)	Share in %
Money on account and cash	17.5	0.89
Debt securities (bonds)	1,214.9	61.38
o/w govt securities	1,157.1	58.46
Shares	305.9	15.45
Investment fund units	342.5	17.30
Other	98.6	4.98
Total gross assets	1,979.4	100.0
% of GDP	7.79	

Source: PSzÁF.

In addition to poor yields, the variation between returns of individual funds is striking. This may, after 30-40 years, translate into a 50-60% difference in disposable assets of the best and worst performers (Matits, 2006: 22). Iwasaki and Sato (2008: 102-108) distinguish between asset managers who are chosen competitively on the market and those who are not. Larger funds sponsored by financial institutions outsource asset management to firms internal to the group. There are no incentives to reduce asset management costs: by controlling the rate of outsourcing fees at their discretion, these funds recoup initial investment costs. So it might be concluded that

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lack of transparency and flawed corporate governance explain low net returns of the whole sector, as well as the variation between funds.

This state of affairs triggered a rationalisation of the funded pillar in 2006-2007. The Hungarian Financial Supervisory Authority (PSzÁF) capped asset management and front-end operational fees. To further relax quantitative limits, pension funds are required to offer a selectable portfolio system, consisting of three different portfolios – conservative, balanced and dynamic – with varying risk profiles. The assignment of members depends on the remaining time until retirement. Participants are able to choose among portfolios, however, the dynamic portfolio is restricted to younger workers (Allianz, 2007: 58).

Notwithstanding these improvements, little has been done to tackle the numerous structural inconsistencies. The problem of older workers, who are bound to lose out by participating in the mixed system, is currently unsolved. Two contrasting opinions exist. Pension fund managers claim that these members made a rational and informed mistake, so have to bear the consequences. Others argue that most switchers were imperfectly informed and that adverse selection took place. As a result, these people should be granted another possibility to opt out (Párniczky, interview).

Supplementary pensions

The Hungarian pension system has two supplementary private pension schemes. Despite a total exemption of employer contributions and a generous tax credit, the voluntary mutual benefit pension funds never really took off. The market remained fragmented, participation stagnated, contributions were low and mainly paid by employers. By 2007, less than one third of the 250 funds licensed in the mid-90s operated on the market. Concentration is high, as the 15 largest companies attracted more than 80% of the 1.4 million members (one third of the labour force) and HUF 784 billion assets. If participants are relatively numerous, the per-capita contributions are modest. Being the precursors of the mandatory pillar, voluntary funds display identical problems with respect to performance, operating costs and return volatility (Matits, 2008: 121-135). Due to deficit concerns, tax exemptions and credits have recently been limited. Since 2008, employers can contribute only up to half the minimum wage. These ceilings will probably discourage further participation.

Recently a ‘second’ third pillar was added in order to increase long-term, domestic private investment in the Budapest Stock Exchange (BBJ, 3-9 October 2005). These saving schemes have no portfolio limits and allocation is based on individual choice. Similarly to the third pillar, members receive a tax credit and capital gains are exempted from taxes. Yearly front-end fees and asset management costs are capped (Allianz, 2007: 59-60). Notwithstanding,

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initial membership fell short of expectations. By the end of 2006, instead of the projected 70,000, only ten thousand new members opted for the scheme.

Fiscal viability

The proponents of budget deficit calculations and generational accounting agree that the eligibility restrictions and benefit cuts contained in the 1997 reform ensured, if not the long-term sustainability of the system, at least a burden considerably easier to manage for future generations (Orbán and Palotai, 2005: 21-23; Gál and Tarcali, 2008: 145). In addition, the reform included provisions to raise administrative efficiency and contribution compliance through streamlined collection (for the public pillar) and individual recordkeeping.

In January 1999, contribution collection was transferred from the two social security funds to the Tax Office, which was entrusted with inspection, accounting and prosecution duties. Even though improving compliance was a major objective, most efforts were in vain. If cooperation with tax inspectors proved beneficial to fight evasion, greater involvement of APEH strengthened the view that social security contributions are just another form of payroll tax (Augusztinovics et al., 2002: 49).

Scarce IT resources, bureaucratic resistance and the dreadful state of past Hungarian contribution records played a role in the early demise of the plan to introduce personalised recordkeeping (Fehér, interview; Máté, 2004: 131). This marked a lost opportunity to crosscheck various databases, as different aggregation levels of data submitted to ONyF and to APEH prevent any meaningful comparison, and put an end to the World Bank's assistance. The Bretton Woods institution laconically remarked that by 2000 the IT infrastructure had not been yet developed and that a database of all the insured had not been produced (Palmer, 2007: 37).

As a last attempt, the Pension Insurance Fund tried to raise employee awareness in 2001-2002. Based on the records provided by employers, ONyF informed workers of their acquired pension rights and invited them to verify the data against their employment statements. Feedback was so scarce that the campaign was soon discontinued (Máté, 2004: 149-153).

Nonetheless, failures to increase compliance and efficiency were a lesser evil compared to *ad hoc* benefit hikes and contribution rate cuts. As a consequence of the Socialist Party's limited bargaining, in line with Proposition 4, Fidesz seriously undermined the public pillar's long-term fiscal sustainability as soon as implementation started (Palacios and Rocha, 1998: 199-200). Gál and Tarcali (2008: 149) argue that these measures were motivated by short-term political gains and possibly international tax-competition. The two authors individuate a clear political budget cycle, except during Ferenc Gyurcsány's re-election in 2006. Given the crisis,

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MSzP started to tackle the problem by reversing the reduction in contribution rates and by taxing pension benefits.

Current fiscal projections vary widely, due to ever-changing legislation, but they are all equally gloomy. The Economic Policy Committee (2007: 237) predicts expenditures surpassing 17% of GDP by 2050 and revenue shortfalls of almost 8% of GDP. Holzmann and Guven (2008: 128-130) are more optimistic (owing possibly to the latest amendments) and forecast a long-term annual deficit of 2.9% of GDP, half of that projected for the no-reform scenario.

Political sustainability

As the paragraphs above extensively anticipated, Hungary implemented one of the politically least stable pension reforms in the region. The Hungarian case neatly shows that Proposition 4 applies to relatively normal democratic conditions as much as to a semi-authoritarian system as Croatia. The Hungarian Socialist Party interpreted pension reforms as an internal affair that can be instrumentally exploited to boost the party's electoral potential. The allocation of disproportionate gains to its leftist wing, in the form of policy, office and vote concessions to the successor trade union MSzOSz and limited bargaining with other actors, created disincentives for either Fidesz or MSzP to stick to the multipillar system's original design. The former planned and partially executed a rollback and the latter continued the populist involution by introducing costly and inefficient amendments to the PAYG system. Only recently, amid mounting criticism, was some corrective action was undertaken. Nonetheless, a renewed structural overhaul is probably needed.

Involution under Fidesz

Once in power, the Young Democrats did not conceal their contempt for Finance Minister Medgyessy's multipillar pension reform, fuelled by fiscal concerns and aversion to the policies introduced by the Socialist Party. Continuous legislative changes and Orbán's derogatory approach resulted in growing uncertainty to both the insured and providers.

As a result of unexpectedly high participation in the new system, ONyF's projected deficit for 1998 trebled (BBJ, 23-29 November 1998). At a time of high hopes of swiftly joining the EU and the Euro, Fidesz drafted an ambitious deficit and inflation reduction schedule. Consequently, the new scheme's excessive popularity was a thorn in the government's side. MSzP had entirely neglected the opposition during the legislative process. The concessions to the successor trade union MSzOSz and the option, later repealed, for Hungarian regions to establish mandatory funds and employ political appointees on their boards, convinced Fidesz that pension reforms were not aimed at strengthening private markets and individual responsibility, but at tunnelling benefits out of the new schemes (Hamecz, interview).

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During its term in government, Fidesz reneged on MSzP's pension reforms, excluded labour from the Health and Pension Insurance Fund boards, and transferred their collection functions to the Tax Office.

In order to sustain the private pillar's excessive popularity, the first amendments were legislated already in November 1998. Fidesz resorted to distortional internal financing measures, which included: changes in contribution rates, less favourable indexation and disincentives to join the mixed system. This early package infuriated both fund managers, who had to change their business plans, and pensioner associations, since many of their members pulled the short straw.

The contribution rate diverted to the second pillar, scheduled to stepwise increase during the following years, stayed frozen at 6%. The public pillar was not corrected to indemnify the participants to the mixed system, who ended up donating part of their contributions to the Pension Insurance Fund (Simonovits, 2008: 82). The cut-off age, above which participation to the new schemes becomes disadvantageous, fell significantly (Rocha and Vittas, 2002: 82). Concomitantly, a long-term decrease in employer contributions started in 2000 and continued under MSzP until 2007 (see Table III.8). These reductions aimed to increase Hungary's competitiveness, at the expense of ONyF's future fiscal sustainability.

The introduction of Swiss indexation was suspended and substituted by the definition of flat sums and indexation limits, with low benefits increasing more than higher ones (Augusztinovics et al., 2002: 49-50). On average Fidesz indexed benefits to the actual rate of inflation. This again generated internal savings and worsened the relative income position of pensioners. Indexation rose above price level in 2002 to gain in electoral popularity.

Finally, the government sought to lower transition costs by setting up disincentives to join the funded pillar (Orbán and Palotai, 2005: 12). Whereas the prohibition for PAYG members to become members of the mixed system after August 1999 was retained, the deadline to pull back from it was extended until the end of 2003.

In November 2001, a second reform package reinforced the involution, as the public pillar regained its default status. Participation in the private funds, mandatory since July 1998 for new labour market entrants, became optional from 2002. The shift to voluntary participation had an impact on the guarantees to members of the mixed system. In fact, the obligation of the Guarantee Fund to top up total benefits in case of inadequate returns was abolished. The Fund survived as a safeguard against fraud and mismanagement. Understandably, this undermined one of the fundamental motives that convinced risk-averse employees to switch. Claims that they were given the means to make an informed choice were *a posteriori* demolished.

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Fidesz almost completed the reversal of the 1997 reform. The opinions of György Németh were a source of inspiration. The sociologist claimed that pension privatisation was a bad deal for Hungary. The state had to transform part of its implicit liabilities (leased at submarket rates) into explicit debt (yielding market interest), thereby endangering compliance with the Maastricht criteria (Banyár, interview; BBJ, 8-14 June 1998). PM Orbán unveiled in April 2001 a plan to hurl people back from the funded into the PAYG pillar. Opposition MPs condemned it as foul electoral manoeuvring and pension fund managers warned against knock-on effects across the real economy (BBJ, 23-29 April 2001).

According to Orbán, the public pillar had to be turned into a Notional Defined Contribution scheme that mimics and later substitutes private pension funds. Consequently, career starters would not be obliged to join the mixed system and the minimum pensionable age would be abolished, as benefits would be automatically adjusted to the qualifying period. Fidesz appointed a working group on pension reforms shortly before the 2002 elections, but this did not produce any proposals. The group was split between the supporters of a pure NDC pillar and those in favour of a point system (Banyár, interview).

In addition to the assault against the pension system, the 5 May 1998 Constitutional Court's decision allowed Fidesz to regain control of the social security self-governed boards. Orbán's plan was to eliminate the two boards and substitute them with two financial directorates. MSzOSz officials and the chairman of the Health Insurance Fund, Pál Kovács, argued that the solution violated both the legal security and representation of the insured (BBJ, 1-7 June 1998, 13-19 July 1998).

Notwithstanding, the decision to oust the two anti-democratic, scandal-ridden and overpaid boards was justified. The State Audit Office reported that the social security funds' continued to perform dismally after the reappointment of their boards in mid 1997. Their combined deficit ballooned. ONyF recorded a surplus, but experts agree that the Pension Insurance Fund was somewhat more disciplined simply because of stricter regulation (BBJ, 9-15 November 1998).

After this ousting, the funds' reserve assets were returned to state ownership and used to pay for pension outlays (Máté, 2004: 123). In mid 1999, Fidesz shelved the directorate plan and put the two funds under direct ministerial control. The Ministry of Finance became responsible for their budgets, health care policy was fully delegated to the Health Ministry while the Ministry for Social and Family Affairs took charge of pension-related issues (BBJ, 14-20 June 1999). By then, the self-government adventure was unconditionally over.

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Involution under MSzP

The return to power of the Socialist Party had contrasting effects on Hungarian retirement. On the one hand, the 1997 reform was Premier Medgyessy's brainchild and hence most of what Orbán undid was restored already in 2002. On the other hand, the populist wave that followed the elections did not spare the pension system, thereby aggravating the scheme's fiscal imbalance and worsening the discrimination against participants to the funded pillar.

As for the mixed system's reinstatement, the stepwise increase in second pillar contributions resumed in 2003-2004 and the ceiling for employee contributions increased significantly. Swiss indexation was reintroduced in 2004 and the window for opting out of the new system definitely closed. For one year, those below 30 were again eligible to voluntary opt into the mixed system.

However, MSzP 'forgot' to reintroduce the guarantees that Fidesz abolished. This created a huge problem for second pillar participants, especially for those enjoying early pension privileges (policemen, miners). These would retire before having contributed for 15 years. Such short accumulation period cannot compensate for the renunciation to one fourth of accrued rights. Therefore, the government gave in to pressures and introduced a new guarantee. The insured whose losses are greater than 6% of their potential monopillar benefit are allowed to return to the PAYG pillar until 2013.

In order to compensate for uneven indexation during the Fidesz years, MSzP introduced a *una tantum* increase amounting to HUF 19,000 for each pensioner (3.4% on average, even for new ones). In addition, benefits across cohorts were levelled in 2005 to correct the arbitrary fluctuation of entry pensions due to inconsistent valorisation after 1988. The impact is minor and implementation gradual. In order to offset the decrease in pensions relative to wages, the Socialists phased in the 13th month pension over a three-year period. The net replacement rate rose instead of falling, annulling the beneficial effects of Swiss indexation. Accordingly, ONyF recorded a deficit amounting to 2% of GDP in 2005.

As Premier Ferenc Gyurcsány stepped in after the resignation of Medgyessy, a number of authoritative players entered the deliberative arena and voiced their criticisms in the face of mounting pension-related problems. The World Bank (Impavido and Rocha, 2006) and the Hungarian National Bank (Orbán and Palotai, 2005; Czajlik and Szalay, 2006) published various studies. Independent experts, such as former Finance Minister Bokros, World Bank senior economist Csaba Fehér (BBJ, 24-30 October 2005) and financial specialist Ágnes Matits (2006), voiced their concerns. Former OTP Fund Management CEO Péter Holtzer (interview) inaugurated a high-level forum on portfolio.hu, an on-line financial magazine.

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The analyses individuated various causes for concern: i) the continuous tinkering of past governments with pension parameters, which generated unfair competition between the public and private pillars; ii) the supervisor's incapacity to individuate market failures, which triggered a reorganisation of the Supervisory Authority; iii) the funded pillar's underperformance, which required top-down imposition of corrective measures instead of triggering spontaneous regulation; iv) no progress to amend flawed annuities and the benefit formula changes that will enter into force in 2013.

The criticisms induced Gyurcsány to form two (not one) reform committees: the State reform committee in July 2006 and the Pension reform roundtable soon after. Both proved to be rather ineffective. The Committee met only a few times and upon demand of the government. The roundtable was more consistent, however, no programmatic framework was produced and its chair, Júlia Király, left the post in mid 2007 and was replaced by Péter Holtzer.

Despite the unfavourable circumstances, the government legislated during 2005-2007 a number of patchy reforms, again without sufficiently broad consultations. In addition to introducing stricter second pillar regulation, Gyurcsány reversed the scheduled reduction in contribution rates and started counting retirement benefits towards the tax base. Contributions related to pensions rose by seven percentage points in just two years. Moreover, since 2008, employee pension contributions are excluded from the assessment base of the newly retired, decreasing pension benefits by some 8%. All these measures shall improve the budget by close to 2% of GDP (Simonovits, 2008: 84-85).

Conclusions

The 1997 Hungarian retirement system reform was legislated by an unconstrained executive that resorted to limited bargaining with external actors and regarded pensions as an internal, intra-party affair. The Hungarian Socialist Party forewent numerous policy objectives in order to secure the continuing electoral support of its elite welfare stakeholders, represented by the leadership of the successor trade union MSzOSz. Policymakers introduced amateurish policy solutions, which elicited very negative repercussions during implementation. The side-payments granted to narrow constituencies and other flaws failed to generate continuing political support and triggered waves of policy reversals after each electoral round. As a result of costly and inefficient deviations, the fiscal position of the newly implemented pension system fell back to pre-reform levels.

Already during the 1980s, the Hungarian retirement system provided shelter to scores of economically inactive dependants. Policymakers acknowledged the need to restructure social insurance, but not until the crisis worsened did anything happen. Despite generating the corrupt,

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inefficient and wasteful Health and Pension Insurance Funds, the half-backed organisational changes introduced during early transition managed to keep overall spending at a much lower level than in the other researched cases. So only part of Proposition 1 holds in Hungary. In fact, the room for manoeuvre to enact simple corrective measures was not entirely exhausted when a systemic reform of the pension system started.

After the socialist-liberal coalition seized power in 1994, the near drift into financial crisis cleared the path for Lajos Bokros's retrenchment package. The neoliberal Finance Minister anticipated the retirement system crisis and proposed to fully privatise the pension insurance system, triggering a lively debate and effectively started the restructuring process. Strong internal opposition against the systemic changes envisaged by the Hungarian Socialist Party rendered complex negotiated bargains unavoidable to reach a compromise.

Policymakers instrumentally used the trade-offs present in the Natali-Rhodes framework to push their particularistic agenda. The World Bank advocated the introduction of credit-claiming elements which, according to Proposition 2, play a fundamental role in systemic change. However, the supply of policy innovations was not matched by a strong demand on behalf of the public (which was largely unaware), but rather by the executive's denigratory campaign against the old PAYG pension system.

Following a very heated debate, the Ministry of Finance introduced an innovative multipillar system. In order to secure this outcome, the reform contained costly and inefficient side-payments, and did not create enough incentives to stick to the original policy design. Such uneven allocation of gains and losses was only possible due to political-institutional legacies that, despite the country's democratic character, endowed Hungarian executives with unabridged authority. Accordingly, the Socialist Party's elitism prevailed during policymaking. The 1997 reform was marked by insufficient consultation with civil society, opposition parties, and, as long as electoral concerns were uninvolved, social and even coalition partners.

Instead of building consensus, the trade-offs envisaged in Natali-Rhodes' framework were used to secure the acquiescence of the social-democratic component of MSzP, represented by the Ministry of Welfare and the National Confederation of Hungarian Trade Unions. Apart from granting policy concessions in terms of radically watered-down final policy, the Socialist Party also offered votes and office to the unions. These maintained the control of both social insurance funds. Moreover, policymakers unjustifiably prioritised numerous other elite welfare stakeholders. The unfortunate mutualist corporate governance structure was transferred from the voluntary pension schemes to the new mandatory private pillar and represented a gift to the Supervisory Authority of Voluntary Mutual Benefit Funds.

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Despite all these shortcomings, most liberal commentators acclaimed the reform as a breakthrough and the financial community even upgraded Hungary's credit standing. Initially, it seemed that Hungary managed to strike a fair balance between social adequacy and fiscal sustainability, that is the trade-off contained in Proposition 3. Yet given the discriminatory treatment of winners and losers, rejoicing was extremely short-lived.

According to Proposition 4, limited bargains that do not involve a sufficient number of policy stakeholders not only fail to solve distributional conflicts, they also fail to build the necessary incentives for policymakers to stick to the original reform design. The Hungarian pension reform was born under an unlucky star. Financial interests and ideological beliefs resulted in far from optimal policy solutions. The Socialist Party's propaganda and unilateralism that only allowed an internal debate with its leftist wing triggered both the aversion of the subsequent government, led by the Alliance of Young Democrats, which reversed and abused the system from the very beginning, and a 'negative consensus' of the population, which fled the public schemes *en masse*. As a result, each subsequent election represented a detrimental political budget cycle. Ten years of implementation resulted in the elimination of most fiscal savings achieved by the 1997 reform, worsening the tension between social adequacy and financial viability embodied in Proposition 3.

The blame for the Hungarian fiasco is thus shared. On the one hand, socialists were elitist and imperative. On the other hand, the transformation of Fidesz from liberal to nationalist-conservative impeded constructive dialogue. Nonetheless, the preconditions for a consensual solution that would have improved the system's stability were not entirely absent. February and March 1997 were ripe with meetings between Socialist policymakers, coalition partners and interest groups. Given that part of the opposition moderates supported reforms, their inclusion into the debate would have probably yielded positive results, if only requiring longer negotiations and the participation of political heavyweights.

As it stands, the Hungarian pension system is still in a limbo. Following a wealth of criticism, PM Ferenc Gyurcsány took some steps in the right direction. However, his weakness became soon manifest and ended in his untimely resignation. Further structural reforms are on the agenda but no concrete action has followed. The deep 2008-2009 crisis that severely affected Hungarian finances and private funds only heightened the concern that all these appeals may just be vain.

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IV. Poland

Introduction

After years of incertitude, Poland opted for a political-institutional structure that creates a thick web of checks and balances. These ‘enabling constraints’ crucially limit the country’s executive authority. Parliamentarism, proportional representation, a very fragmented party system and militant, over-politicised trade unions ensured that unilateral and divisive policymaking was frequently an unavailable option for Polish decision-makers. However, given the electoral competition’s animosity, consensual decisions proved to be equally rare.

Polish pension reforms stand out for their radicalism and the encompassing character of policymaking. Common sense dictates that neither could have possibly happened in an environment ripe with institutional and partisan vetoes. Hence, the Polish case clarifies a number of surprising aspects in decision-making. First, Poland shows that despite multiple constraints to the executive, radical systemic reforms are possible. The dimensions present in Natali and Rhodes’ framework are successfully employed to negotiate complex bargains between holders of radically different reform visions. Second, the case demonstrates that the supposed trade-off between decisiveness and resoluteness does not always hold. Not only does broad consensus not always impair a policy’s radicalism, it can also increase its acceptability and continuing support at all levels. Finally, Polish policymaking illustrates that building consensus is a difficult and rare endeavour. Once politicians run out of stamina, the recreation of favourable reform conditions may prove impossible.

Poland stands in stark contrast with cases of divisive policymaking and limited bargaining, such as Croatia or Hungary. The political-institutional structures, the policymaking style and ultimately the reform outputs are totally different. The usual parallels drawn between Poland and Hungary are inappropriate, except for a number of points. In particular, the two countries share a sufficiently large intellectual critical mass to generate a number of alternative proposals to the government’s official drafts. Yet the affinities with the Slovenian case are more marked. The two countries’ executives were constrained in their choices and legislated successfully only when they resorted to inclusive policymaking. When this was not the case, policy dilution, gridlocks and eventually reversals plagued their reform attempts.

The first part of the chapter starts with a description of the complex evolution of political-institutional structures. Two constitutional reforms and changes in the electoral system marked the transition of Poland from an ungovernable semi-presidential system to relatively stable parliamentarism. Both reform legislation and implementation took place in an environment ripe

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with checks and balances and involved very strong pro-welfare actors. Given these constraints, limited bargaining was in neither case possible. However, despite the enmity between opposite political factions, consensus building was unexpectedly achieved.

The Polish pension system is an archetypical case of reformers enjoying the benefit of a crisis. Proposition 1 claims that once simple corrective measures, such as refinancing and retrenchment, are no longer possible, they are followed by paradigmatic reforms involving complex negotiated bargains. Polish retirement was extensively used in early transition to build a social safety net for redundant workers. The crisis hit the system with full force and hence both refinancing and retrenchment became suddenly unavailable options, opening the floor to fundamental restructuring.

Given the diversity of opinions and intellectual depth of alternative proposals to reform pensions, Proposition 1 suggests that complex negotiated bargains are unavoidable. The trade-offs embodied in Natali-Rhodes' framework constitute the basis for exchanging credit-claiming elements for substantial fiscal cuts, as argued in Proposition 2. The impact of the reform's structural elements on the supply and demand for policy innovation is studied to assess how Polish policymakers were able to build consensus around such radical proposal as 'Security through Diversity'.

The chapter's third section presents the reform's output and analyses the fundamental friction between sound social policy and financial viability, which lies at the basis of a publicly acceptable pension system. Proposition 3 warns against excessively strict solutions that adamantly link contributions to benefits, thereby penalising all those insured who fail to build a sufficient contributory record. In addition to the public pillar, the chapter evaluates whether private pension funds constitute a viable alternative to compensate for lower pension benefits provided by the state. The central element of Proposition 4, i.e. the political sustainability of the reformed pension system, is also researched. The chapter traces a decade of reform implementation in Poland and presents all those regulatory details that were omitted during the legislative phase and are, for the most part, still missing.

The transition

Among ex-socialist countries whose extrication was peaceful and which firmly embarked onto a democratic course, Poland developed a very unfavourable political-institutional mix. A polarised party system and unconsolidated division of power, riotous and over-politicised trade unions, which ceased to play their traditional corporatist roles, were some of the key traits of Polish early transition. It took the 1992 Small Constitution to tame the hegemonic aspiration of former dissident trade union Solidarność and its leader, President Lech Wałęsa. The 1993

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electoral law, which substituted the schizophrenic proportional electoral system without threshold, turned the polarised pluralist party system into a moderate one.

After the Left returned to power in 1993, the period of extraordinary (and incompetent) politics ended. Gradually, the political-institutional structure normalised and the 1997 Constitution transformed the country into a parliamentary democracy filled with checks and balances. These consistently prevented decision-makers from unilaterally imposing their policies and occasionally forced them, as in the case of the 1997-1998 reform package that included pension restructuring, to seek broader political consensus.

Notwithstanding, Poland is still plagued with excessive party fragmentation to be effective. Not only has no Polish government managed to stay in power for more than one term, four were ungovernable and four had minority support. Finally, the political system has not yet shed its autocratic tendencies. The short government led by Law and Justice (PiS) threatened, without succeeding, to fundamentally redraw the Polish democratic political-institutional fundamentals.

Extrication and performance

After some successful reforms in the 1970s, the economic situation deteriorated. The protests, martial law and détente culminated in the Roundtable talks between the Communists and Solidarność. Since then, the country's journey from plan to market became a struggle between opposed developmental visions. On the one hand, the liberal wing of Solidarność favoured a privately owned market economy, including a primitive capital accumulation characteristic of 19th century *laissez-faire* (Kowalik, 1995: 133-135). On the other hand, the communist successor parties supported gradual, socially oriented reforms, but frequently had to depart from their values in the face of grave structural problems, e.g. regional disparities, lack of infrastructure, pre-capitalist farming sector.

Deep economic problems started with the Roundtable talks. Many condemn the irresponsibility of the parties involved. Communists agreed to the postulated egalitarianism, the revival of workers' self-government and forced indexation of salaries. These concessions precipitated the country into a deep recession and unleashed the 1989 price-wage spiral that led to rampant inflation and a depressed market (Owsiak, 1995: 154-155).

In order to withstand the emergency, PM Tadeusz Mazowiecki opted for shock therapy, thereby reneging on workers' self-management, an obstacle to restructuring. Public enthusiasm underpinned this neoliberal turn, opening a period of extraordinary politics. Finance Minister Leszek Balcerowicz's Plan was implemented in January 1990 and it successfully liberalised and stabilised the economy. However, lack of institutional preconditions, the budget squeeze, and

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incomplete, defensive restructuring generated enormous social costs in terms of falling real incomes.

Economic reforms were painful, creating disillusion with the transition to a market economy. Solidarność, the labour union, favoured self-management and its government suffocated it. Instead of guaranteed indexation, public companies were levied the penalising *popiwiek* tax on excessive wage increases. Rampant unemployment shattered job guarantees (Orenstein, 2001: 49). In 1992, the successor All-Poland Alliance of Trade Unions (OPZZ) and Solidarność itself started criticising the government's economic policy, almost throwing the country into chaos.

As the Left returned to power, the period of politics as usual finally started. The Democratic Left Alliance (SLD) inherited an economy that gradually rebounded; slowed down the pace of reforms, eased the strictest policies and engaged in more constructive social dialogue. The state sector recovered, unemployment fell and economic growth resumed until 1998. This was followed by four years of stagnation under the new Solidarność government. The coalition promised high growth and the elimination of unemployment. Just the opposite happened. The executive mismanaged the aftermath of the Russian crisis and left the country in shambles. GDP growth was in 2001 the slowest in ten years, unemployment almost doubled and the public debt reached alarming levels (see Table IV.7).

Once again in government, the Left tried to implement a Blairite *third way* that would mix liberalism with social fairness. The endeavour failed as the dire economic situation forced the deepening of liberal economic policies. Since most of SLD's leadership was still attached to the former elites, the neoliberal turn was internally criticised and some genuinely needed reforms, such as the Hausner Plan, failed. Privatisation and investments into infrastructure stalled. Neither unemployment nor inequality abated. Despite both an economic upturn and EU accession in 2004, the continuous economic scandals advantaged the nationalist and populist Law and Justice (Rae, 2008: 138-141).

The rise of PiS and the coalition with ultraconservative Samoobrona and the League of Polish families (LPR) intensified the zeal to lustrate the country's politics and create a Fourth Polish Republic. The Kaczyński brothers often referred to the Third Republic as a post-communist monstrosity, and PiS started a moral revolution to eliminate former elites and to fight neoliberal atomisation. Despite the resumption of growth and lower unemployment (both owing to Poland's accession to the European Union), the two brothers' executive was too short-lived to provoke lasting damage.

Notwithstanding the setbacks, Poland is still regarded as relatively successful: it has a buoyant financial market, it is well integrated into the EU and it was reasonably equipped to withstand the recent global financial crisis.

Political-institutional structures

During the last two decades, Poland witnessed continuous political instability, owing to both unconsolidated institutions of government and electoral volatility. The country started with a strong, uncontrollable presidency, but gradually ended as a parliamentary democracy strictly separating constitutional powers (see Table IV.1 for details). The electoral system has always been purely proportional, rendering coalition governments fragile and unstable. Policymaking required extensive dialogue, especially with the over-politicised trade unions (these forwent their political involvement in 1999-2001). Given the divergences between the two main political factions, i.e. the communist and Solidarność's successor parties, successful negotiated bargains were rare.

Institutions of government

Poland emerged from the Roundtable talks as a semi-presidential system, a trade-off for the first limitedly free post-war elections. The Third Republic was ungovernable due to the riotousness of Solidarność and a proportional electoral system without threshold (see Table IV.2). This state of affairs prompted President Lech Wałęsa to support both a cabinet with special powers and an extremely strong presidency. Premier Hanna Suchocka tempered his authoritative tendencies by passing the 1992 Small Constitution, which only marginally accrued presidential powers (Orenstein, 2001: 40-42, 47-48).

Five years later, in 1997, the coalition government between the Democratic Left Alliance and the Polish People's Party (PSL) promulgated the current Constitution, which mixes a parliamentary with a relatively weak presidential system. The proportional electoral system (corrected in 1993), numerous checks and balances, such as the veto powers of the Senate and President, imply that unilateral decision-making is an unavailable option. Furthermore, Polish executives were weak, as all but one ended as feeble minority executives.

The Constitutional Tribunal played a strong role during the transition, especially against unjustified retrenchment. More than elsewhere, the Tribunal acted as a proposal player in pensions and other reforms, favouring restructuring as a way out of spiralling budgetary overruns. For all these reasons, most Polish governments had their hands firmly tied after the initial period of extraordinary politics was over.

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Table IV.1 Political institutions in Poland

Separation of power political arenas	Actors	Rules of investiture/dissolution elections	Rules of decision-making
Executive	President	5-year term; directly elected; if no candidate receives 50% of votes in first ballot then second ballot; only one reelection; is held accountable before the Tribunal of State for any violation of the Constitution.	Selects the Prime Minister; initiates legislation; issues regulations and executive orders; can veto legislation (*Sejm* overrules with three-fifths vote of half of its members) and submit it to Constitutional Tribunal; dissolves the Parliament when it fails to nominate the Council of Ministers or to pass the budget.
	Prime Minister (*Prezes Rady Ministrów*)	Nominated by the President, proposes the composition of the Council of Ministers; this is confirmed by a vote of confidence in the *Sejm*; the Prime Minister and individual Ministers are held accountable by votes of no confidence (constructive for the Premier) in the *Sejm*; is held accountable before the Tribunal of State.	Right to issue regulations, introduce and propose legislation, adopt a draft state budget and ensure the implementation of statutes.
Legislative	House of representatives (*Sejm*)	4-year term, 460 members; two-thirds of the votes of the majority of members dissolve both the *Sejm* and the Senate; the President calls the elections.	Three readings; the Council of Ministers may initiate an urgent legislative procedure, for which *Sejm*'s committees have to accomplish their work in one month.
	Senate	4-year term, 100 members; plurality bloc voting with two to four senators elected in each district.	Right to initiate legislation; may request changes to or move for rejection of a bill (*Sejm* overrules by absolute majority of its members).
Judiciary	Constitutional Tribunal (*Trybunał Konstytucyjny*)	9-year term, 15 judges elected by the *Sejm*; elects its President for a 3-year term; the President and Vice-President of the Tribunal are selected by the President of the Republic.	Judicial review and broad supervisory rights.
	Tribunal of State (*Trybunał Stanu*)	4-year term (coinciding with that of the *Sejm*), 1 chairperson (the First President of the Supreme Court, appointed by the President for 6 years, is the chairperson), 2 deputy chairpersons and 16 members.	Rules on the constitutional liability of the highest offices of state: President, Prime Minister and members of the Council of Ministers, President of the National Bank of Poland etc; broad prosecutorial rights.
Electoral	Referendum	Compulsory to delegate sovereignty to supranational institutions; ordered by majority of half of *Sejm* members or by the President with the consent of the Senate.	Binding if more than a majority of voters participate.
Territorial units	16 voivodeships (*województwo*); smaller local governments (*powiat* and *gmina*)	The voivode is appointed by the Prime Minister and is the regional representative of central government; 4-year term for regional assemblies (*sejmik*), which elect the regional executive (*zarząd województwa*), headed by the *marszałek*.	Extended powers; issue bylaws, including budget and developmental strategies of voivodeships.

Source: Polish Constitution.

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Table IV.2 Electoral system in Poland (*Sejm*)

Year	Seats	Method for allocating seats
1991	460 of which 391 proportional regional lists 69 proportional national lists	Single-ballot mixed-member PR: - PR in 37 regional districts (between 7 and 17 seats each) with no threshold and Hare-Niemeyer conversion method - PR in countrywide district, with 5% threshold or seats in 5 regional districts and Sainte-Laguë conversion method
1993 1997	460 of which 391 proportional regional lists 69 proportional national lists	Single-ballot mixed-member PR: - PR in regional districts with 5% threshold for parties and 8% for coalitions and d'Hondt conversion method - PR in countrywide district, with 7% threshold d'Hondt conversion method
2001	460 proportional regional lists	Single-ballot PR in regional districts with 5% threshold for parties and 8% for coalitions and Sainte-Laguë conversion method
2005 2007	460 proportional regional lists	Single-ballot PR in 41 regional districts with 5% threshold for parties and 8% for coalitions and d'Hondt conversion method

Source: Państwowa Komisja Wyborcza (www.pkw.gov.pl).

Elections and parties

Even though the instability of the first Polish governments is partly attributable to polarised party competition, the correction of the electoral system without threshold in 1993 did not radically improve the situation. Although the party system became moderately pluralist, political fragmentation did not diminish. Political factionalism and riotousness constantly hindered the country's governability. Moreover, the New Right never shed its autocratic aspirations, frequently trying to destabilise the centre-left power structures and, during the last Law and Justice government, even to redraw the rules of the game. All these features negatively contributed to the ability of Polish policymakers to craft cross-parliamentary consensuses around any complex policy. Table IV.3 and Table IV.4 provide an overview of Polish parties and executives.

The Polish transition to democracy started with the 1989 semi-free elections, dominated by Solidarność. After recognising defeat, General Jaruzelski appointed Tadeusz Mazowiecki, the first non-Communist Polish Premier since 1944. Four Solidarność governments stayed in power during 1989-1992, but they fared disastrously and split over anti-communist lustration, as well as the use of neoliberal policies.

The amateurishness of the conservative coalition stood in stark contrast with the reformed communists. The victory of the coalition between the Democratic Left Alliance and the Polish People's Party marked the beginning of politics as usual and the resumption of economic growth. Notwithstanding, scandals related to the political past of SLD-PSL leaders submerged the executive. In the meantime, Solidarity Electoral Action (AWS) reorganised under union

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leader Marian Krzalewski, a Silesian engineer who replaced Wałęsa in 1991, won the 1997 election and reached an agreement with Balcerowicz's Freedom Union (Szczerbiak, 2001: 93-94).

Although Jerzy Buzek was the first Premier to serve a full term, internal disputes erupted immediately. The government mishandled labour disputes during 1999 and rapidly lost support. Friction between the parties constituting AWS and Premier Buzek's non-confrontational stance were both interpreted as incompetence. The deep disagreement over Finance Minister Balcerowicz exasperated the relationship between the Freedom Union and Solidarność (Rzeczpospolita, 8 October 1999, 1 October 1999). NATO membership and EU acession created more divisions. The coalition collapsed in June 2000, leaving Buzek at the head of a minority government. A conspicuous number of Solidarność MPs left for three other party formations: the liberal Civic Platform (PO), the conservative Law and Justice Party (PiS) and the Euro-sceptic Movement to Rebuild Poland.

In the meantime, SLD led a disciplined opposition under Leszek Miller. The party embraced a pro-market stance, distanced itself from the socialist past and showed willingness to compromise with the Catholic Church. Its electoral slogan was 'A return to normality'. Together with the Labour Union (UP) and in alliance with PSL, the Left returned to power in September 2001 (Szczerbiak, 2001: 94-95).

The four years in government were particularly difficult for the SLD-UP-PSL coalition. The economy stopped declining but did not significantly improve. SLD opted for neoliberalism by supporting a flat tax rate. This prompted PSL to exit the coalition and created a schism between the government and its political base (Rae, 2008: 129-133). Many heavyweights, such as Jerzy Hausner, migrated to other parties. The scandals, corruption and distancing from social democratic values triggered a scorching defeat during the September 2005 elections.

The conservative Law and Justice and more liberal Civic Platform dominated, but split over key ministerial and parliamentary posts. Law and Justice's new minority government, led by Kazimierz Marcinkiewicz, obtained external support from the League of Polish Families and Samoobrona. After his resignation, due to a row with the Kaczyńskis, the three parties formed a proper governing coalition. During the simultaneous Presidency and Premiership of Jarosław and Lech, the coalition drifted into populism, nationalism and religious fanaticism, waded from crisis to crisis and collapsed.

PiS was soundly defeated in October 2007. The Poles signalled their abhorrence of a return to authoritarianism and obscurantism. The elections witnessed the highest turnout since 1989 and Donald Tusk's Civic Platform won by a landslide. An encompassing leftist alliance, Left and Centre (LiD), obtained only a handful of seats.

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Table IV.3 Party system in Poland (parties that won seats at 2004 European Parliament or 2007 *Sejm* elections)

Party family affiliation	Acronym	Party name	Ideological orientation	Establishment and merger details	Foundation
Right	LPR	League of Polish Families (*Liga Polskich Rodzin*)	Eurosceptic, radical nationalist		2001
	SRP	Self-defence of the Republic of Poland (*Samoobrona RP*)	Agrarian populist, Christian socialist		1992
Centre-right	Piast	Polish People's Party "Piast" (*Stronnictwo "Piast"*)	Agrarian, Christian democratic, conservative	Splinter group of PSL.	2006
	PiS	Law and Justice (*Prawo i Sprawiedliwość*)	Conservative	Members of AWS and of eurosceptic Movement for the Reconstruction of Poland (ROP – *Ruch Odbudowy Polski*) joined PiS.	2001
	PO	Civic Platform (*Platforma Obywatelska*)	Christian democratic, liberal conservative	Solidarity Electoral Action (AWS – *Akcja Wyborcza Solidarność*) members joined PO after the coalition disintegrated in 1997-2001 term. AWS was a liberal, conservative and Christian democratic coalition of 30 parties founded in 1996. Successor of the political arm of Solidarność trade union.	2001
Centre	PD	Democratic Party - demokraci.pl (*Partia Demokratyczna - demokraci.pl*)	Social liberal	Successor of liberal party Freedom Union (UW – *Unia Wolności*), founded in 1994, out of merger of Democratic Union (UD – *Unia Demokratyczna*) and Liberal Democratic Congress (KLD – *Kongres Liberalno-Demokratyczny*).	2005
	PSL	Polish People's Party (*Polskie Stronnictwo Ludowe*)	Agrarian, centrist, Christian democratic	Successor to interwar agrarian parties, and communist satellite United People's Party (ZSL – *Zjednoczone Stronnictwo Ludowe*). Current name after a merger of various similar parties in 1989.	1989
Centre-left	SdPL	Social Democracy of Poland (*Socjaldemokracja Polska*)	Social-democratic	Splinter group of SLD.	2004
	SLD	Democratic Left Alliance (*Sojusz Lewicy Demokratycznej*)	Anti-clerical, social-democratic	SLD was a coalition between leftist parties in 1991-1999. At the core was the successor of Polish United Workers' Party (PZPR – *Polska Zjednoczona Partia Robotnicza*), i.e. Social Democracy of the Republic of Poland (SdRP – *Socjaldemokracja Rzeczpospolitej Polskiej*). Formally established as single party in 1999. In coalition with Labour Union (UP - *Unia Pracy*) in 2001 elections.	1991

Source: various (see also http://scenapolityczna.friko.pl/).

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Table IV.4 Polish executives

Date of change in political configuration	Presidential election date	President (party)	President. majority decisive round	Election date	Start of govt	Head of government (party)	Governing parties (seats)	Govt majority (% seats)	Govt electoral base (% votes)
24.08.1989					24.08.1989	Tadeusz Mazowiecki (independent, Solidarność)			
22.12.1990	25.11.1990	Lech Wałęsa (independent, Solidarność)	74.3%						
04.01.1991					04.01.1991	Jan Bielecki (KLD)	Various[1]		
06.12.1991				27.10.1991	06.12.1991	Jan Olszewski (PC)	Various[1]		
05.06.1992					05.06.1992	Waldemar Pawlak I (PSL)	Did not manage to form the executive		
11.07.1992					11.07.1992	Hanna Suchocka (UD)	Various[1]		
26.10.1993				19.09.1993	26.10.1993	Waldemar Pawlak II (PSL)	SLD (171), PSL (132)	65.9%	35.8%
07.03.1995					07.03.1995	Józef Oleksy (SLD)	SLD, PSL		
23.12.1995	05.11.1995	Aleksander Kwaśniewski (SLD)	51.7%						
07.02.1996					07.02.1996	Włodzimierz Cimoszewicz (SLD)	SLD, PSL		
31.10.1997				21.09.1997	31.10.1997	Jerzy Buzek (AWS)	AWS (201), UW until 06.06.2000 (60)[2]	56.7%	47.2%
	08.10.2000	Aleksander Kwaśniewski (SLD)	53.9%						
19.10.2001				23.09.2001	19.10.2001	Leszek Miller (SLD)	SLD-UP (216), PSL until 01.03.2003 (42)	56.1%	50.0%
02.05.2004					02.05.2004	Marek Belka I (SLD)	SLD-UP – minority govt		
11.06.2004					11.06.2004	Marek Belka II (SLD)	SLD-UP – minority govt		
31.10.2005				25.09.2005	31.10.2005	Kazimierz Marcinkiewicz (PiS)	PiS (155) – minority govt LPR (34), Samoobrona (56) – external support; coalition since 05.05.2006	33.7%	27.0%
23.12.2005	09.10.2005	Lech Kaczyński (PiS)	54.0%						
14.07.2006					14.07.2006	Jarosław Kaczyński (PiS)	PiS, LPR, Samoobrona		
16.11.2007				21.10.2007	16.11.2007	Donald Tusk (PO)	PO (209), PSL (31)	52.2%	50.4%

Source: Państwowa Komisja Wyborcza (www.pkw.gov.pl). [1] Fragmented coalitions emanating from *Solidarność*. [2]After that minority governments by Federation Solidarity Electoral Action (FAWS – *Federacja Akcja Wyborcza Solidarność*) and Solidarity Electoral Action of the Right (AWSP – *Akcja Wyborcza Solidarność Prawicy*), both AWS successors.

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Interest groups

Given the weakness of Polish executives, as well as the strength of its elite welfare stakeholders who originated in the vibrant civil society and powerful state bureaucracy, pension reforms were frequently at the centre of political contestation. Very active, over-politicised trade unions and the branches of public administration dealing with retirement, i.e. the Social Insurance Institute (ZUS) and the Farmers' Social Insurance Fund (KRUS), played an overwhelming role in the shaping of the Polish reform debate. The government had to always confront these players, whose consent was ineluctable to reach a negotiated bargain. By contrast, due to the underdevelopment of supplementary private pension arrangements, the financial service lobby appeared only after 1999 (Golinowska and Żukowski, 2007: 11-12).

Sustained political contestation began in Poland much earlier than 1989. Protests during the last decades of socialism were the expression of an untamed civil society. Dissidents institutionalised political opposition in the 1970s and worker representatives, including Lech Wałęsa, established the trade union Solidarność in 1980. This generated a bi-polar model of unionism, where Solidarność opposed the successor union OPZZ along the pro- versus anti-communist cleavage.

As soon as the freedom of association was granted, the labour movement became extremely fragmented. There are three confederations, almost 600 between nationwide unions and federations, and 24 thousand regional organisations. Before transition, labour had extraordinary power, as Solidarność counted almost ten million members. However, due to voluntariness and atomisation, union membership subsequently collapsed, as shown in Table IV.5. Union density is currently just 11-13%.

Table IV.5 Trade unions and membership (2007 and latest)

Independent Self-governing Trade Union "Solidarity" (*Niezależny Samorządny Związek Zawodowy "Solidarność"*)	NSZZ "Solidarność"	600,000-800,000 estimated 722,000 (ITUC, 2007)
All-Poland Alliance of Trade Unions (*Ogólnopolskie Porozumienie Związków Zawodowych*)	OPZZ	500,000 estimated 318,000 (ITUC, 2007)
Trade Unions Forum (*Forum Związków Zawodowych*)	FZZ	300,000-400,000 estimated

Source: European Commission (2008b: 107-108).

During the 1990s, Polish trade unions had strong ties with political parties: Solidarność was part of Solidarity Electoral Action until this collapsed in 2001 and OPZZ was instrumental for the creation of the Democratic Left Alliance, until SLD merged into a party in 1999. Avdagić (2005) claims that these ties strengthened political paternalism on the labour movement. The leadership definitely betrayed their policy aspirations for office guarantees.

Social dialogue was confrontational. The State Enterprise Pact established in 1994 the Tripartite Commission for Social and Economic Affairs, a forum bringing social partners

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together. In Ost's words (2000: 514-515) the Commission appeared only when: *"workers were turning away from the elite's program in 1992-93, and Solidarity as trade union began breaking from Solidarity as reformist government [...]"*. Hence, the forum's main *raison d'être* was to secure the consent of labour to its own marginalisation, thus sidelining its mediatory role.

Despite the instrumental use of the Tripartite Commission and the unions' decline, corporate actors were the main interlocutors for Polish policymakers. The memories of the 1992 strikes were vivid and the confrontation with Solidarność and OPZZ became inevitable, after SLD-PSL rekindled tripartitism. The experience was rather negative, confirming that exchanges mainly ran between the unions and the parties themselves. After years of failed attempts at social dialogue, Solidarność tacitly approved OPZZ's boycott in 1999. It took a thorough reform of the Tripartite Commission and the simultaneous abandonment of political activism by both labour unions to normalise the situation.

Within the public administration, the Social Insurance Institute was, since 1933, almost uninterruptedly responsible for running the Polish pension system. ZUS received legal personality as a state fund during socialism (Rzegotka and Sroka, 2005: 40-41). Supervisory boards were established, represented by labour unions and the public administration (3/5 and 2/5 of board members). ZUS regained its independence in 1986 during a major modernisation effort.

The organisational structure of regional Supervisory Boards changed in January 1996, as half of the board members became representatives of pensioners and the insured, one quarter of employers and the rest of the Ministry for Labour and Social Policy (Żukowski, 1996: 106). The Social Insurance Institution's president remained a political appointee. ZUS's strategic importance is related to the number of its employees (40 thousand before 1999) and to the social partners' managerial functions.

A pre-socialist feature of the Polish labour market is the large share of the labour force working in agriculture. These workers were covered by ZUS until 1991, when the Farmers' Social Insurance Fund (KRUS) was established. The Fund soon became fundamental to nurture the constituency of the agrarian Polish People's Party, despite the need to thoroughly reform it.

KRUS is a particularly problematic institution. Instead of being a social insurance fund, it is rather a social assistance programme, whose beneficiaries outnumbered the insured until 2005. Until recently, it squandered roughly 2% of GDP per year, of which more than 90% was financed by the state budget. The system's simplicity is matched by its inefficiency and proneness to abuse. Neither contributions (flat-rate) nor benefits depend on the farmer's income. Hence, the wealthiest five percent, who produce more than the Polish consumption capacity, are treated identically as the other 95%, who are self-subsistence family farmers. Additionally, many

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self-employed buy the minimum amount of land to qualify for farming, thereby discontinuing the payment of much higher contributions to ZUS.

Pensions

After the refoundation of Poland, the country's social security system was territorially split. Comprehensive white- and blue-collar schemes were created in 1927 and 1933. Due to fragmentation and disastrous self-management, these were unified under the aegis of ZUS (cf. Świątkowski, 1993). Following the German Reich's Insurance Code, both employers and employees paid contributions and the formula was defined benefit. White-collars enjoyed greater privileges and there were separate schemes for miners, civil servants, uniformed services. Self-employed and farmers were excluded.

After taking over, Polish Communists abolished employee contributions and established new working categories. First category workers performed unhealthy, heavy jobs and benefited from a lower retirement age as well as higher benefits than second category workers. The system employed a best-year defined benefit formula, which degressively took into account successive income brackets. Hence, the income distribution flattened even without *ad hoc* indexation (Müller, 1999: 94; Żukowski, 1996: 103). Disability pensions were computed as old-age ones. During the 1960s, coverage expanded rapidly, reaching completion with the creation in 1977 of a separate scheme for individual farmers (Rzegotka and Sroka, 2005: 42-44).

The system ran smoothly until 1975. Then the seeds of its collapse were planted. The disabled and women were allowed to retire at 55 with 30 years of insurance, including long non-contributory periods (maternity leave) and employment in 'very' part-time jobs. Heinen and Wator (2006: 194) impute such laxity to the policy shifts that reflected the role of women in society. Earlier retirement emphasised their grandmotherly functions. Wiktorow (interview) suggests that it was rather a showdown against Western countries' social spending in the 1970s. Either way, the effective retirement age, 61 years for women and over 64 for men in 1978, slid to 55 and 59 by 1992. Circa 80% of new pensioners were under the legal retirement age (Żukowski, 1996: 114).

Several fiscally ruinous concessions further deteriorated the situation. A 1983 decree established two new privileged categories of workers: those employed under special conditions (usually hard or unhealthy) and those performing tasks of a special character (artists, ballerinas, journalists). Ultimately, almost 250 professions enjoyed early retirement rights and repeatedly anticipated pensioning was offered to all, irrespectively of any reasonable criterion. Separate laws and systems covering elite welfare stakeholders appeared. The Teachers' Charter of 1982 granted retirement after 30 years of service, of which 20 spent teaching. Uniformed services,

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judges and prosecutors had a separate, tax-financed scheme. Miners and other potentially dangerous groups benefited from supplementary schemes and were granted privileges. Finally, budget-financed non-contributory periods were easy to obtain. Maternity and paternity leave, years spent in university, in the military, caring for the disabled – they all guaranteed that 30 years of service were but a formality.

In light of the imminent crisis, Proposition 1 suggests that restructuring enters the agenda as soon as the possibilities to retrench and refinance the ailing system disappear. Even though Polish experts proposed systemic reforms very early, two factors explain why serious debate was postponed until 1995-1996. First, insufficient *ad hoc* indexation prevented expenditures from exploding until early transition. Second, pensioners started to be regarded as losers. Solidarność got involved in their defence already in 1982, giving rise to a socio-political trend that opposed any benefit cuts.

The union prevented the further erosion of continuing pensions, a phenomenon that had effectively delegitimised the system. Contribution hikes were needed to compensate for increasing foodstuff prices, so ZUS recalculated most pension benefits upwards. Retirees were promised systematic wage indexation, but financial problems with the Social Insurance Fund (FUS) delayed implementation until 1986. Two years later, prices were soaring so fast that benefits did not keep up, so it became normal to work and earn a pension at the same time (Müller, 1999: 95-96).

Crisis

The pension bomb detonated in 1989-1991, when the *Sejm* passed five acts. The first two dealt with workers who were laid off for organisational, production-related reasons or due to their employer's bankruptcy. They were allowed to retire, irrespective of age, if they had a sufficient contribution record. In 1991, 497 thousand new old-age pensioners and 319 thousand new disabled entered the system. Among OECD countries, Poland had the highest share of disability pensioners in the working age population (Wójcicka, Ruzik, and Zalewska, 2002: 202).

Other measures were as harmful, but socially justified. In May 1990, the *Sejm* introduced minimum pensions amounting to 35% of the national average wage (39% since December 1993) and automatic quarterly indexation to wages. In December, it reassessed the benefits for those aged above 80. Special occupational groups were pampered. Miners were allowed to retire after 25 years of underground work, whatever their age.

These amendments increased the pension system's opacity. To achieve some coherence, ZUS recalculated all pensions and introduced transparent redistribution in 1991 (Wiktorow, interview). The base was extended to ten best out of 20 years by 2000, and limited to 250% of

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the national average wage. Contributions, however, were paid in full, giving an incentive to evade to high-earners. The *Sejm* limited gainful employment during retirement.

The new formula was simple (see Chłoń, Góra, and Rutkowski, 1999: 7), but it inflated the benefits of 70% of pensioners, paradoxically increasing the replacement rate. Amid collapsing state revenues, evasion and forgiveness to state-owned enterprises, such generosity rendered the Polish pension system fiscally unsustainable (Chłoń-Domińczak, 2004: 183-191; World Bank, 1994b: 33). Table IV.6 provides a summary of the crisis.

Table IV.6 Polish pension crisis characteristics

	Pension expenditure /GDP	Pension revenues /GDP	Pension balance /GDP	Number of pensioners	Number of insured	Contribution rate	Replacement rate
Effect	**Doubled in 1989-1994, from 6.5% to 15.8% of GDP, declined after.**	**20% decrease in contributions, 5% fall in covered wage bill during 1992-2002.**	**Deteriorated sharply: budget transfers peaked in 1994 at 6.1% of GDP, fell afterwards.**	**Increased by 37.5% during 1989-1999: old age by 56%, disability by 27.3%.**	**Fell by 15% in 1989-1998.**	**Grew constantly during the 1980s, stable at 45% of total payroll during 1990-1998.**	**Rose sharply from 56% to over 72% of average wages in 1989-1991, stagnated until 1996 and then fell.**
Cause	Higher replacement rates, creation of KRUS, early retirement.	Long-term evasion, non-compliance, underreporting and arrear write-offs. The tax authority did not cope with atomised contributors.	Contribution erosion with higher expenditures.	Early retirement laws in 1989-1991.	High unemployment, low participation, self-employment and informal economy.	Refinancing preceded retrenchment.	The new 1991 benefit formula and minimum benefits made the majority better off.

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Table IV.7 Economic and pension system indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Non-KRUS outlays	7.8	11.5	13.3	13.6	13.5	13.3	13.0	13.0	12.9	13.0	12.5	13.1	13.3	13.4	12.8	12.3	12.3	-
KRUS outlays as % of GDP	1.4	1.9	2.1	2.2	2.2	2.2	2.1	2.1	2.0	2.0	1.8	1.9	1.9	1.8	1.7	1.5	1.4	-
SDR – Insured to pensioners	2.49	2.20	2.03	1.89	1.86	1.88	1.84	1.77	1.71	1.76	1.74	1.72	1.72	1.71	1.71	1.75	1.77	1.84
SDR – Pensioners to insured	0.40	0.45	0.49	0.53	0.54	0.53	0.54	0.57	0.59	0.57	0.58	0.58	0.58	0.58	0.58	0.57	0.57	0.54
Age Dependency Ratio (15-64/65+)	15.5	15.8	16.0	16.3	16.5	16.8	17.0	17.2	17.4	17.7	17.9	18.1	18.3	18.6	18.7	18.8	18.8	-
Net replacement rate (old-age)	65.0	72.6	72.6	71.9	73.8	73.6	70.9	67.0	65.0	62.3	59.9	61.8	63.7	65.0	65.0	63.6	63.6	59.2
Insured[1]	13,953	13,539	13,199	12,665	12,787	13,206	13,220	12,937	12,737	13,271	13,060	12,851	12,761	12,739	12,857	13,131	13,354	14,075
o/w in OFEs										9,666	10,419	10,637	10,990	11,463	11,979	11,720	12,353	13,134
OFE assets										0.32	1.24	2.41	3.77	5.25	6.66	8.63	10.96	11.95
Beneficiaries[2]	5,598	6,154	6,505	6,703	6,873	7,036	7,172	7,313	7,466	7,524	7,525	7,469	7,439	7,451	7,504	7,524	7,565	7,659
o/w old age[2]	2,353	2,775	2,982	3,081	3,155	3,230	3,313	3,394	3,497	3,532	3,574	3,662	3,691	3,804	4,012	4,168	4,625	-
o/w disability[2]	2,187	2,318	2,435	2,497	2,567	2,629	2,673	2,708	2,735	2,740	2,678	2,565	2,438	2,323	2,158	2,014	1,594	-
Beneficiaries KRUS	-	1,791	1,990	2,027	2,046	2,049	2,028	2,001	1,969	1,929	1,887	1,842	1,798	1,755	1,709	1,662	1,586	1,508
Insured KRUS	-	1,750	1,650	1,568	1,475	1,427	1,387	1,418	1,415	1,428	1,452	1,502	1,560	1,589	1,540	1,582	1,615	1,598
SDR – Insured to pensioners	-	0.98	0.83	0.77	0.72	0.70	0.68	0.71	0.72	0.74	0.77	0.82	0.87	0.91	0.90	0.95	1.02	1.06
Unemployment	6.5	12.2	14.3	16.4	16.0	14.9	13.2	10.1	11.0	15.1	16.6	18.5	19.7	19.3	18.0	16.7	12.2	8.5
GDP growth	-11.6	-7.0	2.6	3.8	5.2	7.0	6.2	7.1	5.0	4.5	4.3	1.2	1.4	3.9	5.3	3.6	6.2	6.6
Inflation	585.8	70.3	43.0	35.3	32.2	27.8	19.9	14.9	11.8	7.3	10.1	5.5	1.9	0.8	3.5	2.2	1.2	2.5
Wage growth	-	-	-	-	34.6	31.6	26.5	21.5	16.7	37.7	12.7	7.2	3.5	3.2	4.0	9.8	5.0	9.1
Budget balance	3.1	-2.3	-5.3	-2.8	-2.8	-4.4	-4.9	-4.6	-4.3	-2.3	-3.0	-5.1	-5.0	-6.3	-5.7	-4.3	-3.8	-2.0
Public expenditure	-	44.6	50.5	50.3	51.1	47.7	51.0	46.4	44.3	42.7	41.1	43.8	44.2	44.6	42.6	43.3	43.8	42.6
Public debt	95.1	81.8	86.7	88.7	72.4	49.6	43.9	43.0	39.5	39.7	36.8	37.6	42.2	47.1	45.7	47.1	47.6	45.4
C/A balance	1.1	-1.7	-1.8	-3.1	1.0	0.6	-2.1	-3.7	-4.0	-7.4	-5.8	-2.8	-2.5	-2.1	-4.0	-1.2	-2.7	-4.1
External debt	78.7	61.5	56.4	54.9	47.1	37.7	30.3	31.6	34.4	39.0	40.6	37.8	42.8	49.5	51.3	43.7	49.6	55.2

Source: KRUS, ZUS, GUS, OECDStat. ADR: HNPStats (World Bank). Economic indicators: European Bank for Reconstruction and Development (EBRD) (http://www.ebrd.com/country/sector/econo/stats/sei.xls). [1]Yearly average. [2]On 31 December of each year.

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Early responses

In order to refinance this exploding expenditure, the total contribution rate progressively increased to 45% and the state budget subsidised ZUS, which became unable to meet its commitments. Despite the opposition of the pro-welfare coalition, retrenchment became unavoidable. Instead of immediately eradicating the problem through lower indexation, the government reduced the assessment base to 91% in 1992 (this tinkering was discontinued in 1994-1995, when the assessment base started to stepwise increase). A wage-price mix finally substituted wage indexation in October 1996. The introduction of pre-retirement benefits slowed down the early retirement of workers dismissed for operational reasons. Disability pensions underwent a redefinition in 1997 and the assessment of disability shifted to a prognosis on the capacity to continue prior employment or undertake rehabilitation. Medical determination, doctors' responsibility and treatment were strengthened. However, the benefit formula did not change and expenditures decreased owing to less favourable indexation (cf. Wójcicka, Ruzik, and Zalewska, 2002: 165-172).

Reaction

The abovementioned benefit cuts trimmed expenditures and triggered protests that marked the fall in support for Solidarność. Tiny pensioner parties, e.g. the National Party of Old-age and Disability Pensioners, successfully campaigned against unmotivated retrenchment. During the centre-left government, the Constitutional Tribunal consistently ruled against curtailing state commitments to pensioners for fiscal reasons and supported systemic reform. The Tribunal held strong views about restructuring. It helped to preserve branch privileges intact, required the full acknowledgment of previously accrued rights, and demanded a transition period before the cessation of early retirement privileges (Aleksandrowicz, 2007).

That the Tribunal prevented politicians from using short-term cost-saving measures and consequently unblocked the political gridlock against systemic reforms was crucial for Poland (Hausner, 2000: 214-215). In line with Proposition 1, the Tribunal declared simple corrective measures as unviable and started the restructuring phase. The plethora and divergence of alternative reform proposals implied that crafting complex negotiated bargains became key to successfully reforming the Polish pension system.

Restructuring

The Polish legislative process was the lengthiest in the region. Three peculiarities characterise this reform: the technocratic policymaking approach by the Plenipotentiary's Office,

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the government's active placement at the centre of dialogue, and the unbundling of reforms between two different executives.

Żukowski (interview) argues that selling a partisan reform to the public was impossible due to excessive Left-Right animosity. Hence, most of the Office's members were strategically unaffiliated in order to carry out the complex negotiations envisaged in Proposition 1. As a result of unbundling, the easy, second pillar laws were legislated during the SLD-PSL government, and the difficult ones, i.e. those regulating the public pillar and ZUS, by the AWS-UW coalition.

Under the centre-left coalition, Finance Minister Grzegorz Kołodko presented two follow-ups to the Balcerowicz Plan: 'Strategy for Poland' and 'Package 2000'. As the World Bank (1994b: 36-38) advocated a multipillar system for Poland, 'Strategy for Poland' adopted a similar standpoint (Kołodko, 1996: 63). However, the ideological clash between Kołodko and Labour Minister Leszek Miller produced a long political stalemate. To exit the impasse, social security expert and World Bank official Michał Rutkowski required the creation of an independent team of experts (Hausner, interview).

The third SLD Premier, Włodzimierz Cimoszewicz, unblocked the situation by appointing Labour Minister Andrzej Bączkowski instead of Miller. The independent Minister was perfect for the occasion. He endorsed paradigmatic reforms, crafted a gentleman's agreement with Solidarność and appointed collaborators who were close to the Freedom Union. The problem where to place Rutkowski's team found a natural solution. Bączkowski became the Plenipotentiary for pension reforms in August 1996 and he set up the relative Office. Yet merging healthcare and pension reforms proved impossible. As Plenipotentiary the powers of Bączkowski increased, allowing him to modify original draft policy and bypass his deputies (Hausner, 2000: 219). Appointing Rutkowski as the Office's chair was also a wise move. Being himself a Pole, Rutkowski enjoyed freedom that he did not have as a World Bank official. Hence, it was not only Polish politics but also the right choice of personnel that bestowed on the Bank a more constructive role in Poland than in Hungary or Croatia,.

The Office obtained massive assistance from international organisations. USAID financed the improvement of regulatory capacity. The Swedish International Development Agency supported the NDC pillar and distanced 'Security through Diversity' from Latin American precedents. The Phare Consensus programme funded the reorganisation of ZUS and ILO experts offered technical advice (Perek Bialas, Chłoń-Domińczak, and Ruzik, 2001: 32-34).

Debate took place in several deliberative fora, the preferred one being the *Sejm* (Orenstein, 2000: 72). At governmental level, SLD established an inter-ministerial working group consisting of representatives of all Ministries. This streamlined work and brought disagreements to the fore. When multilateral agreement failed, intermediation of the Premier

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proved essential (Hausner, 2000: 220). The main forum to confront the social partners was the Tripartite Commission.

Under SLD-PSL, the Office's existence was threatened twice. In November 1996, Labour Minister Bączkowski unexpectedly died. The 1997 reform of the government's economic centre then rendered incompatible the positions of Plenipotentiary and Minister. The double problem of whom to appoint and under which Ministry arose again.

The new Labour Minister Tadeusz Zieliński, a labour lawyer who considered a funded pillar devoid of any social element, publicly despised 'Security through Diversity' and continuously obstructed the course of reforms. Jerzy Hausner, SLD's chief economic adviser, accepted the Plenipotentiary post, provided that it operated under the Premier's direct supervision. Owing to time constraints, the Office, chaired now by Marek Góra, was not moved to the Chancellery and it became an independent department within the Ministry of Labour. This generated much interference, because Zieliński disapproved of draft laws not being examined by the Socio-political Committee of the Council of Ministers (Hausner, interview). Nonetheless, by February 1997, 'Security through Diversity' was already finalised and the Tripartite Commission endorsed it shortly after, guaranteeing popular support for the funded pillars.

Instead of running into difficulties, the Plenipotentiary strengthened its position under AWS-UW. Solidarność and the Freedom Union signed an electoral agreement to continue working on an encompassing reform of the public sector. PM Jerzy Buzek retained the Office and Ewa Lewicka became the new Plenipotentiary in November 1997. Her mandate differed from Hausner's. She depended on the Ministry of Labour and Social Policy, and faced the daunting task of reforming the old system.

Surprisingly, cohabitation with the Labour Minister was easy. In fact, Ewa Lewicka was simultaneously in charge of the supervision of ZUS as undersecretary, and of pension reforms as Plenipotentiary. She was able to table proposals to the Council of Ministers without consulting Minister Longin Komołowski, who in any case was pro-restructuring. So Lewicka acted like a separate Minister for pensions: during inter-ministerial consultations, the Labour Minister was *de facto* prevented from rejecting a Plenipotentiary's proposal. Consequently, the passage through government of such complex legislation was relatively smooth (Lewicka, interview).

Greater impasse happened with the establishment of an Extraordinary Commission in the *Sejm*. After much bickering between AWS and UW, Jan Lityński was elected head by the Freedom Union and SLD. By then, the political window of opportunity to pass first pillar legislation was closing fast. Finance Minister Balcerowicz carefully monitored rising pension liabilities and was therefore pushing to immediately close the old system down (Lewicka, interview).

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Excessive haste in the final stages provoked unfavourable side effects. Apart from postponing the regulation on bridging pensions, Solidarność failed to draft the annuities law and overlooked vital reform details. Implementation was scheduled to start in January 1999. Hence, ZUS, the Superintendency for Pension Funds (UNFE) and Pension Fund Societies (PTEs) could not adequately prepare, tarnishing the reform's domestic and international image.

Policy trade-offs

Notwithstanding these flaws, the Plenipotentiary achieved two main strategic goals. First, it skilfully employed the credit-claiming potential of systemic reforms, a key aspect of Proposition 2, and convinced the public that multiple objectives are obtainable at once. Second, it exploited the Natali-Rhodes reform dimensions and merged into a coherent document very distant policy positions. In fact, 'Security through Diversity' pays tribute to alternative reform proposals, which originate in the 'socio-political', 'fiscal and cost', as well as 'financial and capital' pension debate trends (Office, 1997: ii; Golinowska, 1999; Ratajczak, 2005).

The reform's four policy aims were to institute a defined-contribution, partially-funded, multipillar pension system that guarantees high replacement rates (Golinowska and Żukowski, 2007: 6-10). The rationale was to achieve widespread consensus by not prioritising any of the objectives and by giving the impression that they can be simultaneously fulfilled, as presumed in the preamble of 'Security through Diversity' (Office, 1997: ii-iv).

Since achieving the four aims is easier said than done, Polish reformers and interest groups faced significant trade-offs. The two chief objectives were financial viability and economic competitiveness, that is, to generate surpluses already in 2011 and to slash contribution rates by five percentage points. The public was more interested in the reform's tangible aspects: equity as elimination of unfair redistribution and effectiveness through private provision.

There was a significant convergence between the demand for policy innovation and its supply. Both finance experts (enjoying World Bank and IMF backing) and the general public, supported a Notional Defined Contribution system (is this what you meant?). The public shared a 'negative consensus' against the old, defined benefit schemes based on intergenerational solidarity (Perek Bialas, Chłoń-Domińczak, and Ruzik, 2002: 7). Surveys were unambiguous. Two thirds of respondents assessed negatively the system's functioning and condemned its lack of transparency. By April 1997 a vast majority supported 'Security for Diversity'. 84% of those surveyed favoured accumulation in individual accounts, 73% agreed upon a tighter cost-benefit link, and 68% supported funding (Chłoń, 2000: 7-9, 11-12, 65).

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The creation of a Notional Defined Contribution system encapsulating an updated concept of equity gained acceptance. Discharging the state in favour of private funds inflamed the public and the use of multipillar terminology served as successful propaganda (Góra, interview). De-etatisation was just an obfuscation strategy concealing the aim to lower benefits through defined contributions (Chłoń, 2000: 23; Golinowska and Żukowski, 2007: 9-10). The excessively optimistic assumptions employed in 'Security through Diversity' corroborate this.

More difficult than convincing the public was to harmonise existing alternative proposals. The fiscal and cost trend favoured financial viability, but its stance towards pension privatisation was ambiguous, due to the double-payment problem (Ratajczak, 2005: 188). Finance Ministers, starting with Leszek Balcerowicz, reacted against overspending and demanded a fiscally neutral system. In addition, they required the breakdown of the Social Insurance Fund into sub-funds for old age, disability and survivors, work injury, sickness and maternity and the relegation of non-contributory elements to the budget (cf. Góra, 2003: 11-14; Bjork, 1995; Gronkiewicz-Waltz, 2003). Employers wary of high contributions had less influence. The trend's only comprehensive proposal was Deputy Labour Minister Irena Wóycicka's White Paper, which linked benefits to financial constraints, without introducing funded elements (Golinowska, 1999: 192).

The financial and capital trend, mainly consisting of neoliberal economists, supported funding and produced as many as five competing projects (cf. Nelson, 2000: 240-241). The most important were Marek Mazur's plan under Finance Minister Kołodko that gave a strong initial impetus, the official 'Security through Diversity' plan and Ewa Lewicka's programme for Solidarność, which also supported funding and was decisive for the union's approval (Ratajczak, 2005: 188-189).

The possibility to attain high replacement rates through funding convinced the socio-political trend, i.e. the labour unions, pensioner parties, social insurance lawyers, Labour Ministry and ZUS officials, whose main interest was defending pensioners' interests. The most important players, Solidarność and OPZZ, favoured higher benefits through partial pension privatisation due to the aging of their members. Yet the enthusiasm of Solidarność and the reluctant acceptance by OPZZ had different underlying motives. The former championed a popular form of capitalism, that is, the assignment of shares of state-owned enterprises to the pension funds.[19] The latter just wanted to maximise its leverage in tripartite negotiations.

Ultimately, the unions' chief objective was to obtain a *quid pro quo* between privileges for their elite welfare stakeholders and a fiscally sustainable system for everyone else

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[19] Ewa Lewicka foresaw the distribution of enfranchisement vouchers, in line with the primitive capital accumulation favoured by Solidarność (Hausner, 2000: 222-225). This leads to governance and pricing problems, hence, privatisation revenues were simply earmarked to repay the public debt (Müller, 1999: 120-121).

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(Golinowska and Żukowski, 2007: 10-11). Watered-down policy solutions were constituent parts of those political trade-offs needed to garner support for 'Security through Diversity'.

Political trade-offs

Extensive dialogue with a plurality of actors proved crucial for the political acceptability of systemic reforms. It was exceptional for Poland, where inclusive policymaking that co-opts the opposition is rare (Żukowski, interview). Notwithstanding, Natali and Rhodes' political trade-offs had still to be instrumentally used. The Plenipotentiary's attempt to separate its policy objectives from the vote and office aims of the executive partly failed. If the official educational campaigns promoted the pension reform and presented it as a *fait accompli*, very tiresome and protracted bargaining with the social partners, opposition and public administration led to suboptimal policy choices.

The Plenipotentiary launched two information campaigns, the first in May 1997. The World Bank sponsored trips for politicians, journalists and union leaders to reformer countries Argentina, Chile, Hungary and Sweden. The campaign employed opinion leaders to communicate with the public. Direct targeting started in 1998, after polls indicated that people were incapable of making an informed choice about joining the funded pillar (Chłoń, 2000: 20-22). USAID cosponsored the project. The Plenipotentiary availed itself of Pension Fund Societies (PTEs) to disseminate information. This was biased and the massive employment of agents inflated the campaign's costs (Ratajczak, 2005: 201). PTEs outspent the Plenipotentiary twenty to one.

As a counterbalance, the Plenipotentiary (and marginally the Superintendency for Pension Funds and ZUS) started to provide impartial guidance. The Office used a plurality of media sources and made an effort to redress the ads that proved ineffective. The participation of Ewa Lewicka in various commercials greatly improved the situation. Public awareness increased from less than 50% in March 1999 to over 80% one year later (Chłoń, 2000: passim).

Even though the public showed increasing acceptance of fundamental restructuring, the Plenipotentiary Jerzy Hausner acknowledged the subordination of policy to vote-seeking goals. The main tactic to make reforms palatable was to avoid creating cleavages. Consequently, the government vowed not to increase taxes, social contributions or decrease existing benefits. Older workers and pensioners were excluded from reforms. By exploiting the generational cleavage, the Plenipotentiary attracted the support of younger cohorts and marginalised other fault lines, especially employers-employees and poor-rich (Hausner, 2000: 226-227).

As much as popular endorsement, political consensus was crucial due to the change in government in September 1997. Plenipotentiary Andrzej Bączkowski reconciled the internal divisions within the SLD-PSL camp and bridged the gap with Solidarność. The Office focused exclusively on old-age retirement, neglecting the reform of disability pensions and of KRUS, a concession to the rural electorate of PSL. Other omissions, i.e. prosecutors, judges and uniformed services, were a deliberate move to keep narrow interest groups out during the pre-electoral period (Hausner, 2000: 229). Overall, concessions were relatively meagre. As for cross-parliamentary consensus, Bączkowski was not the only bipartisan appointment within the Office. Many collaborators were affiliated with the Freedom Union and Solidarność's parallel research was seriously taken into consideration. The relations between the two teams and personal ties between Bączkowski and Lewicka were cordial. Consequently, the *Sejm* voted the first three laws almost unanimously.

After the change in government, the broad agreement on 'Security through Diversity' started to crumble for two reasons: frictions within the AWS-UW coalition and its refusal to collaborate with SLD; rising tension between policy and vote-seeking targets due to the debate on public pillar legislation.

During the years in opposition, former Labour Minister Leszek Miller headed SLD. He never supported the Plenipotentiary's ideas and mobilised the party against its own reforms in order to undermine the credibility of Solidarność. Furthermore, the consensus between AWS and UW deteriorated. Solidarność appointed its officials to the most relevant posts: Ewa Lewicka as Plenipotentiary and Stanisław Alot as president of ZUS. UW responded in kind by appointing Jan Lityński to the Extraordinary Commission. Souring relations and SLD's obstructionism (its unionist faction opposed defined contributions and the curtailment of occupational privileges) forced the pace of parliamentary debate and compelled the centre-right coalition to legislate single-handedly (Orenstein, 2000: 51-56).

The first pillar law generated unprecedented controversy. Disagreement mounted both within the coalition and with social partners. These were until then relatively satisfied. The vicinity to Solidarność's ideas, irrational expectation of high returns, and an active role in the supervision of private funds secured the approval of trade unions. However, the positions on equalised retirement age, indexation, on the elimination of occupational privileges and of separate schemes for railway workers and miners were hard to reconcile.

In addition to indexation, which was promptly relaxed, the hottest item on the agenda was the equalisation of pensionable age at 62 (Office, 1997: 29). The proposal was too progressive for Polish traditional values. Strong public aversion against equalisation rendered a departure from the status quo unattainable. Surveys between 1995 and 2007 show that the vast majority of respondents support differentiated pensionable age and that early retirement became a deeply entrenched women's right (Chłoń, 2000: 58-59; Szczepańska, 2007b). Moreover, family policy

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failures, such as the withdrawal of the state from social and childcare provision, relegated women to their traditional maternal function (Heinen and Wator, 2006; Aleksandrowicz, 2007: 336-337). Given the political revival of the Catholic Church and the impossibility to convince the labour movement, Solidarność opposed equalisation. Apart from Economy Minister Janusz Steinhoff, AWS voted compactly against it (Lewicka, interview).

Notwithstanding, other battles within the Council of Ministers were more successful. The Plenipotentiary's decision to reunite all existing legislation into one comprehensive law allowed for the inclusion in the new system of most elite welfare stakeholders: miners, teachers, part of the uniformed services and other professions.

Curtailing special privileges was no easy task. Instead of questioning the NDC concept, the unions accepted its underlying rhetoric, but demanded a *quid pro quo*. The Tripartite Commission did no work out a common position, the Federation of Trade Unions of Polish State Railway Employees mobilised against reforms, and Silesian miners from Solidarność occupied the Labour Ministry in October 1998. As a major concession, older workers representing their core constituency retained some special and most early retirement rights. Bridging pensions, which are financed via higher employer contributions, had to cover the period between early and normal retirement age (cf. Aleksandrowicz, 2007: 337-338).

These were a necessary compromise between the Plenipotentiary's orthodoxy (elimination of most privileges from day one) and the need to sweeten the bitter pill. Clearly, vote-seeking prevailed over policy objectives. Instead of eliminating early retirement, those eligible were granted exemptions and a transition period. Again, insider categories secured guarantees at the expense of ordinary workers. Table IV.8 summarises policy differences between 'Security through Diversity' and the final output.

Table IV.8 Policy compromises

	Reform proposal	**Reform output**
First pillar		
Retirement age	62 for all	60 for women and 65 for men
Min vesting period	25 for all	20 for women and 25 for men
Early retirement	Elimination	Transition period
Special benefits	Elimination	Bridging pensions; various exceptions
Valorisation	50% wages	75% wages
Indexation	Prices	80% prices and 20% wages
Second pillar		
Annuities	Undefined	Postponed

Source: adapted from Orenstein (2000: 80).

State bureaucratic constituencies were as important for reforms as civil society groups. The collaboration of ZUS was secured in a number of ways. First, the Institution's new president under AWS-UW, philologist Stanisław Alot, was selected for his personal ties and was disinclined towards open contestation. He was preferred to the better-qualified co-author of

‘Security through Diversity’, Aleksandra Wiktorow. Second, ZUS obtained a plethora of new functions: upgraded administrator of the PAYG pillar, transfer agent for the second pillar and collector of healthcare contributions (Chłoń-Domińczak, 2002: 140-141). Finally, the Institution’s administration required modifications. ZUS hired 8,000 new employees during 1999-2003 and management was centralised. One Supervisory Board replaced all regional branches and was set up by tripartite agreement, conferring more office to the unions.

Policymakers recognised that ZUS had the right infrastructure and sufficient absorption capacity to handle centralised collection of healthcare and second pillar contributions (Perek Bialas, Chłoń-Domińczak, and Ruzik, 2001: 39). The expansion of responsibility helped to overcome the administration’s opposition and ZUS was used as scapegoat for initial difficulties. It was unthinkable that it would smoothly implement such complex policy in so short a time. Placing all the blame on ZUS reinforced the belief that the obsolete state administration failed, rather than the new system’s design (Żukowski, interview).

Although the financial service industry was virtually absent, experts agreed to establish the Superintendency for Pension Funds (UNFE). The *ex ante* creation of a supervisory agency pre-empts regulatory overreactions that may follow due to financial scandals (Golinowska and Kurowski, 2000: 7). UNFE substantially eased the fears of a population sceptical of financial markets. Furthermore, the licensing process launched in August 1998 created powerful constituencies that prevented the AWS-UW government from backtracking on its commitments (Orenstein, 2000: 51).

Reform outcomes

The Polish pension reform stands out for its paradigmatic character and for the (partially fulfilled) aim to immediately eliminate the coexistence between old and new systemic elements (Góra, interview). It is regulated by the following laws: Act on Using Means from Privatisation of State Assets for Social Insurance Reform of 25 June 1997, Act on Employee Pension Programmes of 22 August 1997, Act on Organisation and Financing of Pension Funds of 28 August 1997, Act on the Social Insurance System of 13 October 1998 and Act on Pensions from the Social Insurance Fund of 26 November 1998.

Two old-age pension systems have been operating in Poland since 1999. The old pension scheme applies to people older than 50 on the date of entry into force of the reform, the new one to those younger. These are further subdivided into two groups: i) people below 30, compulsorily insured in both the public and private schemes; ii) people aged 30 to 50, who chose whether to adhere to the Notional Defined Contribution scheme only or to both.

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The latter obtained a moratorium of ten (initially eight) years to retire early, if they did not pick the funded pillar and if they fulfilled all requirements under old rules before 2009. Women retiring during 2009-2013, who did not join private schemes, were instead offered a smooth transition between the two systems, consisting of a mixed old-age pension partly under old and partly under new rules.

Previous entitlements were transformed into initial capital credited to NDC accounts. Since many individual work histories were missing (in failed state-owned enterprises or beginning before 1980), some 600 thousand workers may have their insurance period recounted in 2009.

The main reform novelties include (Holzmann and Guven, 2008: 136-137; ZUS, 2008):

– Gradual increase in retirement age to 60/65 years for women/men (completed in 2014). There is no minimum vesting period, except that required for a minimum pension guarantee (20/25 contributory years for women/men), which is triggered if the total pension falls below a certain threshold. The difference is topped up from the state budget.
– Limited possibilities to combine active employment and retirement.
– Change in the PAYG benefit formula. Calculation follows the Notional Defined Contribution logic. Benefits entirely depend on the contributions paid by employees and employers, which have been redefined as shown in Table IV.9. Contributions are capped at 250% of the base amount, thereby implicitly limiting the maximum payable benefit. The notional capital's accrual rate is 100% of the real wage bill growth (75% before 2004). Annuities use unisex life expectancy at retirement, thereby redistributing from men to women. Since 2008, they are indexed to 80% prices and 20% wages.

Table IV.9 Social security contributions in 2008

Contribution	% of total	% financed by	
		payer (employer)	insured (employee)
Social insurance			
Old-age (both pillars)	19.52	9.76	9.76
Other pensions (disability, survivors, death)	6.00[1]	4.50	1.50
Sickness	2.45	2.45	-
Work accidents[2]	0.67-3.60	0.67-3.60	-
Fund of Guaranteed Employee Benefits	0.10	0.10	-
Labour Fund (unemployment)	2.45	2.45	-
Health Insurance	9.00	-	9.00

Source: ZUS (2008: 21). [1]13% until 2007. [2]Diversified contribution since April 2007.

– Creation of the Demographic Reserve Fund (FRD) to stabilise the contribution rate when baby-boomers retire or other demographic fluctuations happen.
– Introduction of Open Pension Funds (OFEs). Their management is shared among public and private institutions. New labour market entrants choose the OFE (otherwise they are assigned) in which they invest their contributions under the supervision of UNFE, now the

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Financial Supervision Authority (KNF). A Pension Fund Society (PTE), a separate legal entity, manages each pension fund. Yet, private pension contributions are collected and allocated by ZUS, which acts as a clearinghouse. On retirement, insured persons purchase a privately provided annuity.

- Introduction of both occupational and individual supplementary private pension schemes.

Table IV.10 presents a summary of the new system.

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Table IV.10 Multipillar system in Poland

Pillar	Zero (non-contributory)			First (mandated, earnings-based)			Second (mandated, earnings-based)			Third (voluntary)		
Provision Financing Objective	Public	Tax-financed Means-tested Basic Benefit	Poverty alleviation	Public	PAYG Non-financial Defined Contribution	Insurance	Private	Financial Defined Contribution	Insurance	Private	Financial Defined Contribution	Insurance

	Benefit	Coverage	Eligibility	Benefit level	Indexation	Beneficiaries	Expenditures %GDP
Basic pension - Zero pillar	Guaranteed Minimum Income	Entire population	Persons with income below a Guaranteed Minimum Income	Approximately 16% of average wage (2006)	Regular increases based on social assistance legislation	NA	NA

		Vesting period	Contribution rate	Contribution ceiling	Benefit rate	Assessment base	Retirement age	Indexation
Old-age pensions – First and second pillars	1st	None. Eligible for minimum pension guarantee after 20/25 years for women/men	TCR: 19.52% 9.76% employer 9.76% employee	250% of national average wage	Depending on life expectancy and notional RoR	Notional capital accumulation	Increasing gradually to 60/65 for women/men by 2009/2014	Mixed price-wage formula, with 20% share of wages
	2nd		PCR: 7.3% employee		Depending on life expectancy and RoR	Accumulated funds		Price-indexed annuity

	Vesting period	Retirement age	Tax treatment (contributions, returns, benefits)	Contributions tax deductible for employers	Lump sum payments possible
Supplementary pensions – Third pillar	5 years	60	Taxed Exempt Exempt Employees are granted tax relief up to 150% of the average wage above which they must pay taxes for capital gains and retirement savings.	Yes	Yes

Source: Holzmann and Guven (2008). PCR – Pillar-specific Contribution Rate. RoR – Rate of Return. TCR – Total Contribution Rate.

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Distributional consequences

Technically speaking, the reform was very progressive. Despite some design flaws and a disastrous start, both the public and private pillars now qualify among the most efficient in the region. Notwithstanding, the trade-off between social adequacy and financial viability emphasised in Proposition 3 represents a significant problem in Poland. The Plenipotentiary plainly neglected the system's benefit adequacy and *de facto* prioritised its fiscal stability over other objectives. The private mandatory pillar has the potential to fill the difference in replacement rates, yet until now it has failed to generate reassuring results. Due to a number of unexpected developments, the system's financial prospects are currently only slightly worse than those projected by the Plenipotentiary. The projections of the benefit levels of less protected individuals are instead much poorer than those presented before 1999. Women suffer from cumulative disadvantages in the new schemes and the current surge in atypical employment will become a cause for concern once the system reaches maturity.

Public pillar adequacy

'Security through Diversity' draws an overoptimistic picture of the adequacy of the multipillar system for future retirees. Following the authors' assumptions, the new schemes are less generous for shorter accumulation periods, yet more than proportionally reward postponed retirement (Chłoń, Góra, and Rutkowski, 1999: 36-39). The second pillar contributes towards entry benefits roughly as much as the first one due to higher returns.

These projections are unreliable. Subsequent evaluations reject the assumptions as excessively confident, given the economic slowdown in 1998-2004 and the fact that people enjoying long uninterrupted careers are increasingly rare (see Holzmann and Guven, 2008: 148-149; Balcerzak-Paradowska et al., 2003). In particular, Jajko-Siwek (2007: 7-10) shows that even high-income employees should buy supplementary private insurance in order to achieve acceptable income maintenance levels. However, only a tiny fraction is voluntarily insured.

The new system is particularly ill suited for atypical workers and women. Increased flexibility and abuse in the Polish labour market clashes with a pension system that encourages workers to yearn for stable contractual relationships (Rymsza, 2005: 30). Atypical forms of employment guarantee lower protection standards than permanent employment. Part-time employment does not yield adequate income levels; fixed-term contracts increase the likelihood of unemployment spells. Civil law agreements are unlawful if they are stipulated with own-account workers, who are in reality fake self-employed and so have lower contribution bases.

Women have cumulative disadvantages. The male breadwinner model has been considerably strengthened as state infrastructure for elderly and childcare collapsed. Marriage is

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encouraged to improve insurance against old age (Benio and Ratajczak-Tuchołka, 2007: 211-214). Finally, the lower statutory retirement age, coupled with similarly shorter accumulation, decreases the replacement rate by almost 30%.[20]

The ongoing discussion on the introduction of redistributive elements yielded some tangible results. In 2004-2005, wage valorisation was introduced and full assessment bases started to be used for older pensions. Since 2009, childrearing women have their bases calculated on minimum wages and not on the much lower social allowance. These measures signal the attentiveness of Polish policymakers, yet are just drops in the ocean of what should be done.

Private pillar adequacy

The implementation of private pensions was extremely problematic in Poland and characterised by widespread fraud, negative returns, lack of self-regulation and profound distrust between the regulator and pension funds. These elicited the Supervision Authority and the Polish Chamber of Pension Funds (IGTE) to advance conspicuous policy improvements. As the situation normalises, Poland may possibly develop the most important pension fund market in the region. A number of design flaws, however, still wait to be addressed and supplementary pensions need to be further developed.

Market developments

Implementation started with the establishment of the supervisor, UNFE, and the ensuing licensing process. 21 licensed pension funds engaged in an aggressive campaign to recruit members. UNFE monitored the business practices of PTEs in four areas: provision of information, registration of agents, protection of clients' rights and transfer of members (Golinowska and Kurowski, 2000: 42).

Misleading advertisement and sales agents represented substantial problems. The Supervision Authority registered them without any proper selection process or knowledge requirements. By December 1999 there were more than 440 thousand agents (2% of the labour force). PTEs treated these people as unqualified seasonal workers (cf. Rzeczpospolita, 10 February 1999). Consequently, unchecked fraudulent behaviour resulted in more than three million dead accounts, i.e. accounts into which no contributions flow. Due to crosschecks with ZUS, these are now a marginal problem.

Fund managers used different strategies to convince prospective members to join. Building the fund's image on established parent companies worked best and, apart from PZU, which is 100% Polish, foreign insurance providers control the largest funds (Chłoń, 2000: 32-33;

[20] The problem is temporary. European Council Directive 54/2006/EC on equal treatment in employment imposes a legal obligation to equalise retirement age.

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Chłoń-Domińczak, 2002: 183-185). Despite the Supervision Authority's efforts, six licensed OFEs disappeared through mergers and takeovers. Since 2005 the market is consolidated, as shown in Table IV.11. Concentration was relatively high, as four funds managed more than two thirds of assets belonging to 64% of members.

Table IV.11 OFE market in December 2007

	Members	% share	Net assets (PLN mio)	% share
AEGON OFE	351,050	2.67	2,945.3	2.10
AIG OFE	1,070,319	8.15	11,467.6	8.19
Allianz Polska OFE	327,001	2.49	3,458.5	2.47
AXA OFE	608,538	4.63	6,194.1	4.42
Bankowy OFE	445,941	3.40	4,274.6	3.05
Commercial Union OFE BPH CU WBK	2,725,239	20.75	37,324.0	26.65
OFE DOM[1]	313,882	2.39	2,085.2	1.49
Generali OFE	538,874	4.10	5,264.5	3.76
ING Nationale-Nederlanden Polska OFE[1]	2,591,613	19.73	32,870.2	23.47
Nordea OFE	731,651	5.57	4,950.6	3.54
Pekao OFE	291,799	2.22	2,245.2	1.60
OFE Pocztylion	431,409	3.28	2,826.1	2.02
OFE Polsat	301,267	2.29	1,276.2	0.91
OFE PZU Złota Jesień	1,959,058	14.92	19,301.4	13.78
OFE Skarbiec-Emerytura	446,440	3.40	3,547.5	2.53
Total	13,134,081	100.00	140,030.9	100.00

Source: KNF. The four biggest funds are highlighted in grey. [1]Since April 2008: OFE WARTA and ING OFE.

As for their portfolios, Polish pension funds invest more than one third of assets in equity and became major players on the Warsaw Stock Exchange (see Table IV.12). Two factors account for greater exposure to risk capital. First, Poland is alongside Romania the only market in the region whose size is relevant. Second, it is one of the few Eastern markets where, instead of German or Austrian companies, Anglo-Saxons and the Dutch dominate the business (Kostkiewicz, interview).

One problem is that such exposure is risky if not hedged. Draconian portfolio restrictions, such as the 5% investment limit in foreign assets and the proscription to invest in derivatives, augment the vulnerability to bubbles. These limits should be overcome at once, given the unsatisfactory performance in critical years.

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Table IV.12 Portfolio structure 31 December 2007

Asset class	Amount (million PLN)	Share in %
Domestic assets, o/w	138,139	99.0
Treasury bond and bills	83,642	59.9
Bank securities and deposits	3,524	2.5
Equities	47,848	34.3
Not treasuries debt instruments	2,380	1.7
Other	745	0.5
Foreign assets, o/w	1,455	1.0
Shares	918	0.7
Total assets	139,594	100.0
% of GDP	11.95	

Source: KNF.

Performance

After initial difficulties, Polish funds generated reasonable returns during 2003-2006, due to falling interest rates and a buoyant domestic equity market. In line with warnings that both sources of profit neared exhaustion (Rudolph and Rocha, 2007: 15-17), the subprime mortgage crisis shattered two years of investment. 2008 marked the worst performance in a decade, a staggering 14.15% nominal loss. Otherwise, yields were fair, but swinging widely. Since 2000 the average annual real rate of return was 5.13%.

Two regulatory solutions hinder healthy competition among PTEs. First, there are minimum rate of return guarantees, relative to the performance of other funds and hence rarely triggered. Despite relaxations in 2004, the guarantee breeds herding behaviour, as investment in riskier assets carries the danger of underperforming the market. To avoid this, Stańko (interview; 2003: 24-30) proposes the introduction of an external benchmark. Second, the fees charged by PTEs have been all capped due to the inability of the industry to self-regulate. Hence, cost-based competition is no longer possible (Kostkiewicz, interview). Notwithstanding, Rudolph and Rocha (2007: 20-23) argue that Polish funds compare well internationally, as centralised collection via ZUS generates economies of scale. Others disagree and propose the institution of a clearinghouse to avoid direct contacts between funds and members, which inflate marketing costs (Rzeczpospolita, 29 May 2006).

Supervision and self-regulation

The other source of instability during the first years of operations was the irreconcilability between the positions of the Supervisory Authority and the Polish Chamber of Pension Funds. The reform of both institutions eased mutual relations.

Pension fund supervision, at first entirely managed by UNFE, became integrated as cross-sector financial products developed. Under chairman Cezary Mech, supervision was reactive, that is, unable to pre-empt market failures, and the relationship with pension funds conflictual. The first serious analysis, 'Security through Competition', was met with shock by market

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participants (Rzeczpospolita, 10 February 2000; UNFE, 2000). The industry despised this Chilean way of regulating everything and SLD Labour Minister Jerzy Hausner accused Mech of souring market relations.

In April 2002, UNFE became the Insurance and Pension Funds Supervisory Commission (KNUiFE) and Mech was ousted. As a result, KNUiFE's professionalism improved, as did the relations with the supervised entities (Kostkiewicz, interview). Four years later, Law and Justice introduced a two-step consolidation plan. The project was criticised for creating a bureaucratised and politicised institution (Rzeczpospolita, 29 March 2006). Notwithstanding, KNUiFE and the Security and Exchange Commission merged. Finally, the Financial Supervision Authority (KNF) incorporated banking supervision in 2008.

The Authority's tasks expanded as well. Initially, UNFE regulated the pension fund market by supervising day-to-day operations, licensing PTEs and imposing penalties (Golinowska and Kurowski, 2000: 42-45). Now KNF's tasks include the development of sound financial market competition, regulation, information and amicable resolution of disputes.

Notwithstanding these improvements, the institution's excessive politicisation persists. KNF is a central government administration body overseen by the Council of Ministers and is financially dependent on the budget and the contributions of supervised entities. The Authority can neither issue its own regulations nor officially submit legislative initiatives. The PM appoints the institution's chairman for five years, usually for political reasons. Hence, the Authority is never fully independent. This is mitigated only by the possibility to recall the chairman.

In order to represent funds and defend them from UNFE, the Polish Chamber of Pension Funds was founded in May 1999. In line with its statute (cf. IGTE, 6 January 2004), the Chamber draws ethical principles for PTEs, disseminates educational and promotional material, establishes contacts with the public administration and local government, participates in the legislative process and collaborates with domestic and foreign financial actors. IGTE evolved in three ways: it instituted a professional direction, it improved the cooperation with institutional interlocutors and it started focusing on self-regulation and public education.

In the beginning membership was voluntary and the presidency rotated between CEOs of individual PTEs. Half of membership fees were paid in proportion to the funds' assets and half were split. Accordingly, the big five elected two board members each, while smaller ones appointed one (Kostkiewicz, interview). This solution balanced the influence of bigger and smaller funds, but suffered from very short institutional memory and weak coordination. Due to scarce effectiveness, in November 2002 IGTE introduced the two-year professional Presidency and Review Commission. Former Plenipotentiary Ewa Lewicka has chaired the Chamber ever since. Membership is still voluntary, but it now entails one vote and equal fees for everyone. The

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drawback is the defection of smaller funds due to flat-rate fees (three OFEs are out) and their insufficient involvement in the Chamber's activities (Lewicka, interview).

During the early years, UNFE's nationalist protectionism exacerbated the conflict with the Chamber. The Superintendency opposed mergers between funds and proposed to limit the funds' role as active investors by curbing their voting rights (Rzeczpospolita, 30 May 2001; UNFE, 2000: 152-160). The tension eased with the departure of Cezary Mech and with each consolidation in financial market supervision (Golinowska and Żukowski, 2007: 29).

Despite general improvement, IGTE's complaints on investment limits or the relative minimum return guarantee did not produce tangible results (cf. Rzeczpospolita, 12 December 2005). In addition, Labour Minister Hausner signalled during 2002 the need for more self-regulation. PTEs were accused of being costly, opaque and not competitive. So fees were capped and switching tightly regulated in September 2003, definitively curbing future competition (Rzeczpospolita, 11 September 2003, 7 August 2002).

As a result, IGTE shifted its strategy from reaction to pre-emption. First, the Chamber decided not to table any regulative proposals, because they would get distorted during parliamentary discussion (as happened with fees). Second, the Chamber started to influence public opinion through educational campaigns to garner support when ameliorations needed to be introduced. Finally, the adoption of codes of conduct was a major improvement. The most important were the Standards of good practice for transfers and acquisitions, adopted in July 2003, which tried to limit unfair behaviour and the poaching of members; and the more general Standards of good practice of institutional investors, adopted in October 2006 (Lewicka, interview, and http://www.knf.gov.pl/).

Supplementary pensions

In addition to mandatory schemes, policymakers introduced occupational and individual pension plans in 1999 and 2004. Employee Pension Programs (PPEs) and Personal Pension Accounts (IKEs) are sometimes called pillars three and four. Regrettably, their role in private pension provision is still marginal.

By December 2007, just 1% of registered enterprises offered circa one thousand PPEs. Less than 3% of total employees participated. Two reasons account for the scarce popularity of these plans. First, Polish employers did not adopt any mechanisms to prevent poaching, especially due to high unemployment (Allianz, 2007: 76-77). Second, tax incentives are insufficient. In April 2004, PPEs were simplified, liberalising contributions, unblocking investment and widening tax exemptions, but the effects were limited.

IKEs represent a complement to PPEs. The government grossly overestimated the number of opt-ins, expected to reach 3.5 millions in a few years (cf. Rzeczpospolita, 4 January

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2005). By June 2008 there were 873 thousand insured (some 5% of total employees) with assets worth PLN 1,8 million, which is less than in 2007. The reasons for the scarce appeal are again inadequate tax incentives, penalties for early withdrawal and high overall social security contributions (Szczepański, 2007).

Fiscal viability

The reform's original long-term objectives were ambitious. Under the baseline scenario the new system would generate surpluses as early as in 2011 and the overall savings rate would rise from zero to 5% of GDP by 2020. The diminution of first pillar contributions from 12.22% to 7.3% would be possible without generating deficits, mainly owing to lower benefit levels (Chłoń, Góra, and Rutkowski, 1999: 51-54).

Later forecasts are less optimistic. The transition to a funded system (fully debt-financed) triggered a financial deterioration that exceeded the losses caused by the second pillar. The deficit increased by 3% during 1999-2003, contributing to lower national savings and a rapid increase in public debt (Rudolph and Rocha, 2007: 7-8). FUS will then run decreasing deficits until 2037. KRUS's deficit should stabilise at 0.3% of GDP, due to fewer beneficiaries (EPC, 2007: 279-283).

The slight relapse in FUS finances had interrelated sources. First, hasty legislation resulted in implementation failures during 1999-2000. As a result of low capacity to monitor contribution compliance and the cap on the contribution base, ZUS was obliged to ask for commercial loans. Consolidation of the IT system, higher sanctions and the definition of responsibilities improved the situation (Chłoń-Domińczak, 2002: 150-151). Second, the economy slowed down in 1999-2003 and unemployment sharply increased, worsening the System Dependency Ratio (SDR). Price indexation in a period of low wage growth and *ad hoc* benefit hikes granted to pensioner associations increased replacement rates. These started to abate in 2007 (cf. Chłoń-Domińczak, 2006: 144; Rzeczpospolita, 20 September 2000).

The system is therefore vulnerable to external shocks. Any further deterioration may crowd out more useful social protection expenditures (cf. Żukowski, 2005: 111-112). Notwithstanding, PiS decided to halve contributions for disability pensions in 2007. Despite the positive effect on competitiveness, lower contributions do not trigger an automatic adjustment in benefits, since disability insurance is still based on defined benefit formulae (Wiktorow, 2006: 158-160). In fact, additional budget subsidies to FUS were earmarked, amounting to circa 1.6% of GDP for 2008 (Rzeczpospolita, 20 April 2007). In sum, it becomes obvious that insufficient attention has been devoted to the conversion of implicit liabilities into explicit obligations (Golinowska, 2006: 173-174).

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Political sustainability

Proposition 4 argues that negotiated bargains underpinning fundamental reforms are qualitatively very different from one another. In particular, the proposition contends that limited bargaining not only allocates gains and losses unevenly, but also undermines the incentives to stick with the reform's basic features in the future.

The Polish experience can be regarded as positive. Despite side-payments and stalemates, the Plenipotentiary crafted a politically sustainable deal with both political and corporatist actors. The inclusion of multiple reform views into 'Security through Diversity' was its seal of approval. Polish retirement underwent less fundamental changes during implementation, compared with other reforms in the region. Given the systemic nature of change and the unfinished agenda, fine-tuning and fallbacks were to be expected. Notwithstanding the initial difficulties and the deterioration of public confidence, the system's basic design was never put under serious discussion. By the same token, the broad consensus that underpinned reforms did not materialise again. The Hauner Plan failed and multiple postponements of bridging pensions infuriated powerful interest groups. These managed to win concessions that represent a dangerous precedent. Finally, the annuities law for second pillar benefits and other regulatory details are not finalised after more than a decade of discussions.

At the beginning of implementation, ZUS had essentially two problems (Chłoń-Domińczak, 2002: 140-153). The plethora of new tasks were too demanding and the notice too short. Moreover, president Stanisław Alot was unfit to withstand the crisis. As a result, FUS's finances deteriorated and public support declined. The disarray was temporary, but it made the headlines until 2000.

Excessive haste led to the omission of important regulative details, which caused difficulties in the implementation of new regulations, lacunae in the IT system and organisational inefficiencies.

ZUS had to build from scratch multiple overlapping databases. For old-age insurance only, the Institution prepared central registries for the insured, contribution payers and second pillar members. Until 1998, firms employing more than 25 people did not provide any individualised information. This created a communication breakdown: employers' mistakes impaired the capacity of ZUS to correctly perform its tasks. Penalties were introduced and all enterprises employing more than 20 people (later five) were since 2001 obliged to provide information electronically, thereby drastically diminishing inaccuracy.

The identification of employees, employers and self-employed was a continuous source of problems. ZUS performed the Herculean task of censing the entire insured population,

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eliminating most dead accounts in OFEs. It also introduced (in collaboration with the Labour Ministry) a new, uniform ID number for contribution payers (Wiktorow, interview).

The new IT became operational only in mid-2002, when it started to register contributions to individual accounts and process their transfer. Due to these delays, the Institution's capacity to correct errors or handle individual reports was initially minimal. In May 1999, ZUS transferred to private pension funds not more than 5% of what was due (Chłoń-Domińczak, 2004: 168). To make things worse, the system for monitoring payments was discontinued, allowing employers to evade contributions undisturbed.

By replacing many mid-level managers with political appointees, the new president Stanisław Alot added pervasive incompetence to administrative problems. Even the Strategic Plan to provide ZUS with a clearer vision and enhance its institutional capacity was sidelined due to the crisis.

Alot came under crossfire by both government and the opposition. Finance Minister Balcerowicz sent the tax administration to monitor ZUS's worrying condition (Rzeczpospolita, 5 October 1999, 10 September 1999). Towards the end of 1999, Alot was substituted with Lesław Gajek, an actuary and Labour Ministry's former advisor. Gajek drew a crisis-management plan that reinstated the old administrative software to improve monitoring, developed the new IT, and required Pension Fund Societies and employers to correctly identify the contributors (Rzeczpospolita, 1 April 2000).

The plan fixed the most glaring loopholes. Restructuring continued in 2001 with the '100 percent' plan, aimed at improving the precision of processed information. Total accuracy exceeded 95% after two years, due to better control of informational inputs, and the massive hiring of employees in 1999-2003 (Chłoń-Domińczak, 2004: 170-171). Consequently, the debt towards private pension funds was finally calculated, transferred in July 2003 to the State Treasury and gradually assigned to OFEs.

In view of the initial problems, the decision by AWS to dismantle the Plenipotentiary was inconsiderate. Leaving ZUS on its own was a strategic choice that ultimately harmed Solidarność. The Democratic Left Alliance exploited the Institution's failures and harshly attacked PM Jerzy Buzek's cabinet (Rzeczpospolita, 30 October 2000). Given the concomitant, underwhelming performance of pension funds, public confidence in the new system deteriorated. By 2007 almost half of respondents were dissatisfied and demanded further changes (Szczepańska, 2007a).

Notwithstanding these difficulties, there were hardly any attempts to overturn the multipillar system. Exceptionally, an SLD deputy in the *Sejm* proposed to suspend second pillar operations until the economic situation improved. Experts and even President Kwaśniewski

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dismissed the plan, because it would require compensation to shareholders, create losses to the insured and undermine investors' trust (Rzeczpospolita, 13 September 2001, 22 August 2001).

Unfinished agenda

Even though major policy reversals did not happen, further reforms stalled after 1999 and almost a decade of policy paralysis followed. The reform of KRUS and tax-financed security provision systems is being debated at the time of writing. A brief account of Hausner Plan's failure, of bridging pensions and of the law on annuities follows.

In 2002, the freshly elected SLD-UP-PSL executive drafted its 'Economic strategy'. This contained concrete proposals to rationalise those parts of social security neglected by the previous, AWS-UW government, such as the implementation of IT in ZUS and the legislation of bridging pensions (Rzeczpospolita, 23 June 2001, 7 February 2002). Yet continuing economic slowdown and increasing deficits shifted the attention of Premier Leszek Miller and Finance Minister Marek Belka to the strict constitutional limits on budget spending (e.g. Rzeczpospolita, 26 June 2004). Soon after accession to the EU, the European Commission started an excessive deficit procedure.

Miller assigned the task of rationalising the budget to Labour Minister Jerzy Hausner. Initially Hausner was just in charge of social security reforms. By adding the economic portfolio in January 2003, Hausner became the coordinator of Polish socio-economic affairs. He drafted the so-called Hausner Plan to stop the budget deficit and public debt from deteriorating. The Green Book 'Rationalisation of social expenditure in Poland' aimed to cut almost 4% of GDP in 2004-2007 (Rzeczpospolita, 9 October 2003).

The Plan had three sections: an economic part, aimed at restructuring failing Polish industries (railways, mining, healthcare, defence); a part dealing with public administration, its employees and costs; and a social part, whose objective was to curtail social security expenditures. The latter was the continuation of Hausner's earlier projects, which had already met with resistance from SLD, especially the proposed limits to combining active employment and retirement (Rzeczpospolita, 25 March 2002). As shown in Table IV.13, the Plan represents the only serious attempt to finalise the reform started in 1999.

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Table IV.13 Hausner Plan's social part

Cost-saving measures
Gradual increase from 60 to 65 of female retirement age, during 2014-2023 (initially 2009-2018).
Introduction of flexible retirement for those aged 62-65.
Gradual limitation of pre-retirement benefits.
Re-examination of previously awarded disability benefits.
Changes in valorisation.
Professional activation of people older than 50 (Programme 50+).
Shorter sickness benefits, limited to 70% of last wage.
Social security reforms
Law on bridging pensions.
Tightened eligibility criteria for disability benefits.
Reform of KRUS.

Source: Rzeczpospolita (16 January 2004).

Despite extensive consultations that started in October 2003, not only the opposition, but also part of the governing coalition disapproved of the austerity package. In the corporatist arena, only employer associations showed some appreciation. OPZZ was open to compromise, but Solidarność and the young Trade Union Forum were adamantly opposed. Despite the resistance of social partners, Hausner's draft law was submitted for debate in April 2004, to be withdrawn and irremediably downgraded soon after.

The SLD-UP minority government (PSL quit in March 2003) entered a deep crisis, which culminated with PM Miller's resignation in the wake of EU accession. Marek Belka became the new Premier and made a strategic mistake by splitting Hausner's Ministry into two. Jerzy Hausner became the Minister of the Economy and Labour, while his former deputy, Krzysztof Pater, was appointed Minister for Social Policy. Pater and his successor Izabela Jaruga-Nowacka (a Labour Union left-winger) blocked many of the Plan's original propositions, until Hausner quit in March 2005.

PM Belka's weakness increased beyond hope. As for what was left of the Plan's social component, the SLD-led minority government had to forego the equalisation of retirement age and the re-examination of disability benefits to withstand yet another vote of confidence, threatened by the splinter SdPL (Rzeczpospolita, 4 August 2004). In November, the *Sejm* failed to pass the limitations to active employment of early retirees and disabled outside protected jobs (Rzeczpospolita, 20 November 2004). Finally, in December, bridging pensions and the reform of KRUS were abandoned. This watering down nullified over half of the originally planned savings (Rzeczpospolita, 16 December 2004). Hence, the centre-left cabinet only marginally rationalised social security. At a minimum, the eligibility rules for pre-retirement benefits and the procedures to check the inability to work were substantially tightened.

An even more tortuous legislative course awaited bridging pensions, which AWS-UW promised in 1998 to swiftly legislate, but never carried through. Before the elections, the minority government led by Solidarność feared the law's electoral consequences. Despite

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Lewicka's pledges to finalise an almost completed act, Labour Minister Longin Komołowski decided to drop the issue (Lewicka, interview).

The following, centre-left coalition feared even worse. Already in 2003, SLD-UP excluded part of uniformed services from the reformed system and repositioned them into a budget-financed scheme (Rzeczpospolita, 1 October 2003). Towards the end of term, the situation degenerated. The reluctance to pass the law on bridging pensions irritated miners' representatives; especially those older workers who acquiesced to reforms in exchange for transitory arrangements. In July 2005, miner unions gathered some eight thousand workers and staged street riots in Warsaw (Lewicka, interview). Just before the elections, the *Sejm* voted for the unlimited continuation of early retirement privileges for miners. Moreover, ordinary workers were granted one additional year of moratorium as bridging pensions were again postponed. Despite the disapproval of the executive, opposition party Civic Platform and the Confederation of Polish Employers, President Kwaśniewski failed to impose his veto (Rzeczpospolita, 29 July 2005).

In addition to its considerable cost, the coherence of the new pension system was slightly undermined. Miners returned to their pre-1999 situation, which guarantees them old-age and disability benefits that are higher than the average national wage. Chłoń-Domińczak (Rzeczpospolita, 3 August 2005) immediately warned against the dangers of such a precedent. In fact, encouraged by the miners' success, railway workers, teachers and metalworkers demanded more of the same. The government partly gave in and granted bridging pensions to teachers and railway workers up to the 1968 birth cohort (Aleksandrowicz, 2007: 338).

During its two years in power, PiS discussed bridging pensions but no legislation followed. The much criticised Minister of Labour and Social Policy, Anna Kalata (Samoobrona), carries most of the blame. Two main issues emerged. First, the discrimination of members of the choice group who joined the second pillar had to be dealt with. They were deprived of early retirement rights, but could not have predicted a change in the law or a deadline extension. During 2006, OPZZ loudly demanded to let them opt out of the new system (Rzeczpospolita, 18 July 2006). A solution was found in January 2007, when a number of strictly defined categories were allowed to leave OFEs and retire earlier (Rzeczpospolita, 19 February 2007, 29 January 2007).

Second, a fundamental disagreement concerned the number of people that the law on bridging pensions should encompass: the government wanted to limit it to 300 thousand, while trade unions insisted for 1.2 million (Rzeczpospolita, 20 July 2007). Experts, such as Marek Góra, criticised even the former figure. The stalemate led to a renewed postponement of early retirement deadlines until the end of 2008.

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Donald Tusk's coalition government eventually solved the impasse. After the three union confederations threatened a joint strike and President Lech Kaczyński almost refused to sign the bill, some 270 thousand workers (predominantly employed under heavy and unhealthy conditions) obtained the right to bridging pensions from 2009. This ended a decade of policy paralysis in Polish social affairs.

The last bit of forgotten legislation, which once more shows that consensus around reforms is extremely difficult to recreate, is the unfinished annuities law, the Achilles heel of Polish private pension provision. During the past ten years, the disagreement between policymakers and the financial service industry intensified. The bone of contention was whether provision should be decentralised or not. Decentralisation would benefit private providers and dispel fears of publicly channelled investment. Centralisation would instead render annuities cheaper and avoid the inefficiencies of a retail market (Góra, interview, and for different views Rzeczpospolita, 29 November 2006).

The first project, already drafted under AWS-UW, foresaw gender-specific life-expectancy tables. The solution was discarded, since it lowers benefits for women and increases spending on minimum pensions (Chłoń-Domińczak, 2002: 138). The draft discussed by PiS in mid-2007 was again unsatisfactory (Rzeczpospolita, 13 April 2007, 30 May 2007). The government headed by the Civic Platform promised to act swiftly. Yet one of the laws approved by the *Sejm* during 2008 incurred in the Presidential veto on equity grounds. After more than a decade of bickering, a definitive solution is not yet in sight.

Conclusions

The 1997-1998 pension system restructuring in Poland represents the region's most successful instance of inclusive decision-making within a political-institutional environment ripe with extensive checks and balances. The employment of the trade-offs present in the Natali-Rhodes framework was in this case aimed at obtaining the acceptance of a wide array of actors, ranging from civil society interest groups to opposition parties and prominent elite welfare stakeholders. Despite involving some relatively costly side-payments, the reform rewrote the underlying social contract, thus significantly gaining in political sustainability. Of course, the policy outcomes are far from being flawless. By introducing an actuarially strict system, policymakers sacrificed redistribution for their fiscal objectives. In addition, the impossibility to recreate sufficient consensus during implementation obstructed the finalisation of some key outstanding issues.

In contrast to the political chaos reigning until the 1997 Constitution, Poland opted for shock therapy already in 1990, when the neoliberal Balcerowicz Plan stabilised and liberalised

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the economy. If growth resumed almost instantly, the transition was socially painful and led to double-digit unemployment, the expulsion of millions out of the labour force and mass emigration. In this context, the existence of a generous pension system accommodating redundant workers preserved social peace. The transformational recession precipitated the pension crisis. Early retirement and lax disability brought the system to its knees. Amid budget and spending cuts, the replacement rates of pension benefits increased instead of falling. The ratio of contributors to pensioners fell sharply, pushing the Social Insurance Institution to the brink of collapse.

Further refinancing was out of the question and the Constitutional Tribunal ruled out unjustified retrenchment. The emergency set off the region's liveliest debate on the future of retirement. Proposition 1 corroborates this by suggesting that, under critical circumstances, the space to enact simple corrective measures contracts and restructuring enters the agenda. Given that the divergence in concepts and the number of competing proposals led to a protracted impasse during the centre-left SLD-PSL coalition government, complex negotiated bargains became necessary to break the deadlock.

The task was delegated to the Plenipotentiary for Social Security Reform. The Office, conspicuously financed by the World Bank and adequately staffed with renowned Polish officials, engaged in very extensive negotiations and skilfully employed all the trade-offs contemplated by Natali and Rhodes to craft a negotiated agreement. Nowhere as in Poland did Proposition 2 bear such weight. Policymakers successfully exploited the credit claiming potential of structural innovations to increase their room for manoeuvre. Given a broad 'negative consensus' against the old public PAYG system, cross-parliamentary accord underpinned the reforms, thereby involving the subsequent centre-right government led by Solidarity Electoral Action. The result was the professional document 'Security through Diversity', which led the way to the most advanced pension system reform in Central, Eastern and Southeastern Europe. The arrangement stands out for its radicalism, because policymakers used a clean slate approach and simply shut down the old system.

Despite political prowess, the reformed retirement system of Poland embodies some trade-offs that cannot be possibly reconciled. Golinowska and Żukowski (2007) posit that the policymakers' aim was to win the public over by deliberately not prioritising any reform dimension, and by giving the impression that their simultaneous attainment was possible.

In reality, not only was financial viability prioritised over all other objectives, competitiveness included, but many concessions were also granted to various elite welfare stakeholders. These side-payments were a *quid pro quo* between the Plenipotentiary's radical policy objectives and the need to maintain the voting base of powerful constituencies. Overly

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unionised categories (miners, teachers, railway workers) were guaranteed privileges and longer time to adjust than ordinary workers, especially those outside standard employment relationships. The reform strengthened the male breadwinner model, so penalised the weakest categories of women.

Proposition 3 suggests that the distributional consequences of the Polish pension reforms are worrying. Excessive emphasis on the system's projected fiscal balance clashes with sound social policy. In Poland, the adequacy of future benefits hinges on individual histories of full and uninterrupted employment, seriously exposing certain groups (holders of atypical jobs, unemployed, women bearing children) to the risk of old-age poverty. Despite an ongoing debate on greater redistribution, a disillusioned population may well trigger policy reversals if no corrective action is undertaken.

Polish policymakers, similarly to other reformers, undertook implementation too lightly, triggering a series of minor setbacks in 1999-2000. Yet the worst implications of Proposition 4 did not take place. In contrast to the political instability in Croatia or Hungary, and despite the continuous changes in government and sinking public enthusiasm, the reform's basic design has (so far) withstood the test of time. The broad agreement built around 'Security through Diversity' made the Polish pension system resilient in the face of changes in political power. At the same time, however, the consensual conditions that underpinned earlier restructuring never materialised again.

Years of policy paralysis, the rejection of the Hausner Plan in the wake of EU accession, and the systemic deterioration during the short-lived Law and Justice government kept the most glaring loopholes unaddressed. It took almost a decade to legislate bridging pensions and there are fundamental pieces of legislation missing. The retirement system of farmers and uniformed services, the equalisation of pensionable age, and the annuities law need still to be satisfactorily tackled.

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V. Slovenia

Introduction

Among the cases analysed in this dissertation, neo-corporatist Slovenia is endowed with the thickest web of checks and balances. This effectively constrains the manoeuvring of its executives. Due to a political-institutional structure ripe with veto points, fragmented parties, proportional representation and the strongest labour movement in Central, Eastern and Southeastern Europe, Slovenian governing coalitions are continuously reminded that divisive strategies and limited bargaining are not suited to legislate complex socioeconomic policies.

The Slovenian case shall demonstrate the following points. Given multiple constraints, unilateral policymaking either fails or leads to policy reversals and the mobilisation of actors sidelined during legislation. The timely inclusion of those players that wield the greatest influence over policymaking may pre-empt the later breakdown of negotiations. Failure to initially achieve an agreement is usually followed by a more skilful employment of Natali-Rhodes trade-offs, at the expense of policy integrity. In order to obtain at least minimal results, the original proposals are watered down to the point of shedding most systemic elements. This may lead to suboptimal policy solutions and once more require structural reforms.

Since Slovenian policymakers were confronted with powerful trade unions that defended the status quo in social policy, their achievements depended on the willingness to engage in inclusive as opposed to divisive policymaking. Even though broader bargains were at permanent risk of failure, when they succeeded, the agreements yielded considerably better policy results.

Policymaking in Slovenia stands in stark contrast with the decision-making practice of the executives in Croatia or Hungary, and displays more affinities with the Polish case. Much more than in Poland, Slovenian policymakers are not only bound by a consensual political-institutional structure, but also face less divided and numerically stronger unions. Due its small size, Slovenia shares with Croatia a limited capacity to autonomously generate alternative reform proposals. Despite the absence of a critical intellectual mass, the policy distance between the executive and the pro-welfare coalition was much wider in Slovenia during the 1990s. Since unilateral imposition was impossible, one veto actor became determining for the reform's success or failure.

In order to underscore the constraints binding Slovenian executives, the chapter begins with a presentation of the country's political-institutional environment. Given the large consensus needed to peacefully break up from Yugoslavia, the tiny country's elite extrication and institutional development are marked by incrementalism and path-dependence. The creation

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of an extensive web of checks and balances and of a neocorporatist structure are clear vestiges of the past self-management governance. Very few policy domains resorted to shock therapy and, due to slow restructuring, a rather negative connotation is attached to gradualism.

The origins and crisis of the pension system are analysed next. According to Proposition 1, simple corrective measures have only limited applicability, so when refinancing and retrenchment are no longer available options, systemic reforms enter the agenda. The Slovenian case is in this respect peculiar. The crisis had a marked fiscal character as public retirement created a social safety net for redundant workers. However, the system withstood the transformational recession rather efficiently and was not entirely delegitimised in the eyes of the public. The aversion to even minimal retrenchment of parts of the pro-welfare coalition elicited a profound rethinking of the system's structural characteristics.

The chapter continues by tracing the policymaking process of two distinct pension reforms: the 1997-1999 attempts at fundamental restructuring and the successful introduction of mandatory supplementary pension insurance to public employees in 2002-2003. The two instances show how the trade-offs embodied in the Natali-Rhodes framework can be successfully (or unsuccessfully) exploited. Proposition 2 stresses that credit-claiming reform elements increase the room for manoeuvre to policymakers. In both reform attempts, the executive's leitmotiv was to entice the public by proposing policy innovations in exchange for benefit cuts and de-indexation. However, as Proposition 4 suggests, these complex negotiated bargains can be qualitatively poles apart.

It is not accidental that the ex-Yugoslav republic is an outlier, not only in Central Europe, but also around the world. Alongside South Korea and Venezuela, Slovenia rejected the World Bank's recommendations and discarded a private mandatory funded pillar (Orenstein, 2008). The rejection resulted in a chiefly parametric 1999 reform. On the contrary, the bargain with public sector unions on supplementary pension premia worked satisfactorily. The aim of process tracing is to pinpoint differences in the two decision-making processes and show whether divisive or inclusive bargaining is more suitable within a democratically consensual environment.

After presenting the reform output, the chapter evaluates the effects of reforms on the trade-offs between future benefit adequacy and the system's fiscal viability, the object of Proposition 3. It is argued that insufficient resolve to engage powerful elite welfare stakeholder may result in fiscally burdensome measures, requiring substantial fine-tuning at a later stage. Finally, the chapter outlines policy and political developments after 1999, in order to analyse the effects of the two negotiated bargains on the reform's political sustainability, and on the possibility to once again introduce some corrective measures.

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The transition

Slovenia is verisimilarly the only neocorporatist, inclusive democracy in Central, Eastern and Southeastern Europe (Bohle and Greskovits, 2007: 452-453). Its transition from socialism to a market economy was characterised by the preservation of existing power balances and path-dependence of reforms. This legacy of consensualism materialised in political-institutional structures that generate many checks and balances, a moderately pluralist party system and very powerful social partners, especially the Association of Free Trade Unions of Slovenia (ZSSS). These proved to be blessings in disguise. On the one hand, Slovenia avoided the social disruption characteristic of other transformational recessions. On the other hand, its politicians were always forced to engage in lengthy and cumbersome negotiations, and rarely mustered sufficient resolve to face organised interest groups.

Early transition was characterised by a short spell of extraordinary politics. The Democratic Opposition of Slovenia (Demos) led the country to independence and military success during the Ten-Day War against the Yugoslav People's Army. The quarrelsome coalition soon fell apart and gave way to politics as usual, dominated by Janez Drnovšek's Liberal Democracy (LDS). The heir to the League of Socialist Youth of Slovenia not only embarked on a very gradual transition to a market economy, but also formed bipartisan governments: six out of nine executives during 1990-2009 were grand coalitions. As a result, the proper break with the socialist past happened only with the ascendancy in late 2004 of Janez Janša, leader of the conservative Slovenian Democratic Party (SDS). As in the other Central, Eastern and Southeastern European countries, the Slovenian New Right did not shed its autocratic tendencies or its objective to disrupt former socialist oligarchies and political structures. Despite four years of heightened domestic political confrontation, the country successfully integrated into the European Union, adopted the Euro, and presided the European Council.

Extrication and performance

Slovenia is often regarded as a post-socialist success story. After a mild transformational recession, the ex-Yugoslav republic experienced 15 years of sustained growth, which averaged 4.4% in 1993-2007. The unemployment rate was low and, after 2000, inflation fell to Euro-area levels. Hence, both EU accession and Euro adoption proved to be comparatively simple.

Notwithstanding the affluence, two interrelated problems beset the tiny country: the mode of extrication of former socialist elites and slow economic restructuring, owing to the deliberate choice of reform gradualism. Under Janez Drnovšek's LDS governments, transition was marked by continuity and incrementalism. By contrast, SDS's centre-right coalition tried to dismantle the

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liberal democratic legacy. Premier Janez Janša's cadre replacement strategy swept the country and he fully embraced neoliberal economic policy. Lacking enough political clout, protests forced him to withdraw the most radical proposals. The re-election of a centre-left coalition stopped short the experimentations of the Slovenian New Right.

Initially, dismantling the Yugoslav heresy was a complicated endeavour, which endowed the Slovenian transition with idiosyncratic features (Mrak, Rojec, and Silva-Jáuregui, 2004: xxi-xxv). The country's relative wealth, its consensual decision-making and care for social peace implied that, apart from monetary stabilisation, few areas underwent shock therapy. Due to public sector inefficiency and dilution of structural reforms, Slovenian gradualism is often attributed a negative connotation. Building a national from a regional economy and breaking away from Yugoslavia demanded extreme caution and broad consensus (Šušteršič, 2004: 401-404). To peacefully overcome the socialist federation's legacy (the existence of a quasi-market economy, limited pluralism and self-management), Slovenia underwent what Šušteršič (2000: 38-44) calls an endogenous transition. The elites managed to secure political primacy and economic advantages.

The short Demos interlude did not mark a break with the socialist past: both employers and unionised labour retained or increased their resources and organisational structures. The 1989 laws named after the last federal Premier, Ante Marković, allowed for spontaneous privatisation to employees and insiders (cf. Uvalić, 1997). Old elites were socialised into the new political system during the domination of LDS. Sociologists Adam and Tomšič (2002: 440-444) calculated that almost 80% of Slovenian pre-transition elites maintained their status by 1995.

The privatisation of Yugoslav social property lay at the core of two opposed visions on how to allocate economic privileges and hence on the different modes of elite extrication. The Ownership Transformation Act (Uradni list RS, 55/92), which started the privatisation process in November 1992, was a compromise between the gradual, decentralised multi-track privatisation recipe by Korže-Mencinger-Simoneti and the Sachs-Peterle-Umek rapid, free and centrally administered distribution of shares (Simoneti, Rojec, and Gregorič, 2004: 229-230). The first would advantage existing, entrenched elites; the latter would create a level playing filed with those actors not holding privileged economic or political positions, i.e. the emerging New Right.

The final result was a mixture of delayed privatisation, inefficient buy-outs, the creation of hybrid Privatisation Investment Funds, and of quasi-state funds (the Capital and Restitution Fund, KAD and SOD). Failed establishment of proper financial institutions shows the governments' aim to continue managing state-owned enterprises. This undermined public trust in institutional investors, kept strategic foreign owners out of the country, and created powerful yet inefficient players that became the new majority shareholders of the Slovenian enterprise sector.

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Inefficiency and excessive gradualism marked the development of financial services, a sector relevant for this study. During the 1990s, the ex-Yugoslav republic became a universal banking system based on indirect financing, with the stock market relegated to a marginal role (Mramor, interview). Banks were liberalised very slowly and are not yet fully privatised (cf. Štiblar and Voljč, 2004). Private insurance lacked foreign competition, cost efficiency and modern financial instruments (Finance, 7 June 1996). In practice, the *"opportunity for the capital market to play a central role in the Slovenian financial system [was] lost"* (Mramor and Jašovič, 2004: 277). The system was unable to accommodate emerging institutional investors, a fundamental requirement to develop private pension schemes.

In order to wipe out these inefficient legacies, Janez Janša's coalition prepared an all-out attack against gradualism, social-democratic policies and leftist oligarchies. For a shake-up of the Slovenian economy, he hired the so-called young economists, such as Minister for reforms Jože Damjan. These drew an ambitious reform agenda, which envisaged neoliberal reforms, such as the introduction of a flat rate tax. However, words were not matched with deeds and elite struggles for power account for PM Janša's fiasco.

Despite the presence of reform-minded Finance Minister Andrej Bajuk, the SDS-led coalition substituted the subtle clientelism practiced by LDS with an overt and reckless 'cadre tsunami', besieging most Slovenian socioeconomic networks (Delo, 4 October 2005). Janša's unilateralism in pushing a neoliberal-populist agenda clashed against ZSSS's protests and Slovenian consociationalism. Instead of entering a dynamic period of structural reforms, the country embarked on a long, expensive phase of pork barrel politics, in line with the excessively generous coalition agreement (Koalicijska pogodba, 2004). During the 2008 electoral round, Slovenians clearly rejected Janša's confrontational style and voted him out of office.

Political-institutional structures

In contrast to the other three case studies, the Slovenian political-institutional structure did not significantly change (or become challenged) in the post-independence period. The social democratic country maintained all three features that unambiguously constrain Slovenian executives: the neocorporatist institutional setting, where party institutionalisation is low; electoral and party systems that do not generate solid majorities; and the strength of social partners, which have to be consulted on socioeconomic issues. These generate a thick web of checks and balances, which prevent unilateral decision-making or limited bargaining, and render negotiated solutions the norm.

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Institutions of government

Slovenia adopted its Constitution on 23 December 1991, roughly six months after independence. The country is a parliamentary democracy, where the President plays a largely ceremonial role, and an example of asymmetric bicameralism (see Table V.1). While the National Assembly wields almost exclusive legislative power, the second chamber, the National Council, has the right to veto legislation and force the Assembly to vote again on a given issue. The Council is a peculiarity in Continental Europe and a vestige of the Yugoslav self-managed social partnership. Its forty members represent key economic interest organisations (Lukšič, 2001: 22-23).

This and other characteristics, such as the long tradition of social pacts, identify Slovenia as a neocorporatist country, where party institutionalisation is marginal. As shown in Table V.2, the proportional electoral system has low thresholds and does not promote unwarranted party polarisation (Toplak, 2006: 826-827). Hence, before Janez Janša's executive, all but one government were grand coalitions (Lukšič, 2003: 520-523).

Under these conditions, unilateral policymaking is simply not an option in Slovenia. Divisive tactics clash against a series of checks and balances, lengthy and cumbersome legislative procedures, and lots of diverse interests to accommodate, forcing both centre-left and centre-right executives to desist from their most radical pursuits. Ultimately, excessive consensualism turned a frontrunner into a reform laggard in fundamental areas, such as the judiciary, tertiary education and the labour market (Šušteršič, 2004: 405).

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Table V.1 Political institutions in Slovenia

Separation of power political arenas	Actors	Rules of investiture/dissolution elections	Rules of decision-making
Executive	President	5-year term; directly elected; if no candidate receives 50% of votes in first ballot, then second ballot; only one reelection; can be impeached for any violation of the Constitution.	Calls elections to the National Assembly; promulgates laws; proposes to the National Assembly a candidate for Prime Minister.
	Prime Minister (*Predsednik vlade*)	Elected by the majority of National Assembly members; is held accountable by the National Assembly through a constructive vote of no confidence; can ask for a vote of confidence; can be impeached for any violation of the Constitution.	Right to pass decrees, introduce and propose legislation, propose the state budget and enforce laws and other regulations enacted by the National Assembly.
Legislative	National Assembly (*Državni zbor*)	4-year term, 90 members; PR electoral rules in Constitution; the majority of its members dissolve the National Assembly to call early elections; the President dissolves the National Assembly if after a vote of confidence a new Prime Minister is not elected in 30 days.	Three readings; there are summary (for minor acts) and urgent procedures (the government demands the National Assembly).
	National Council (*Državni svet*)	5-year term, 40 members: 4 representatives of employers, 4 of employees, 4 of farmers, crafts and trades, and independent professions, 6 of non-commercial fields, 22 of local interests.	Proposes laws to National Assembly; consultative rights; suspensive veto on a given law prior to promulgation.
Judiciary	Constitutional Court (*Ustavno sodišče*)	9-year term, 9 judges elected by the National Assembly; these elect their President for a 3-year term.	Judicial review and broad supervisory rights; decides by 2/3 majority on the impeachment of the President.
Electoral	Referendum	Compulsory for the accession of Slovenia to the EU; called by the National Assembly, mandatorily if required by one third of deputies, 40,000 voters, the National Council.	Majority of votes and majority of voters.
Territorial units	210 municipalities (*občine*), 11 with urban status	-	Limited local self-government rights.

Source: Slovenian Constitution.

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Table V.2 Electoral system in Slovenia

Year	Seats	Method for allocating seats
1992 1996	90 of which 88 proportional 2 majoritarian for minorities	Single-ballot mixed-member PR system with 3 parliamentary seats threshold (circa 3.2%) at national level: - PR in 8 electoral districts and 11 sub-districts in each. Seats at district level are distributed with the Hare quota system and the remaining at national level with the d'Hondt system - relative majority of voters in single-seat districts for the Hungarian and Italian minorities
2000 2004 2008	90 of which 88 proportional 2 majoritarian for minorities	Single-ballot mixed-member PR system with 4% threshold at national level: - PR in 8 electoral districts and 11 sub-districts in each. At district level (circa 2/3 of seats) are distributed with the Droop quota system and the remaining at national level with the d'Hondt system - relative majority of voters in single-seat districts for the Hungarian and Italian minorities, using the Borda count

Source: Državna volilna komisija (http://www.dvk.gov.si/).

Elections and parties

Throughout transition, Slovenia maintained a proportional electoral system with low thresholds. Party competition was moderately pluralist and political alternation started only after 2000. During 1992-2004 the Liberal-democratic Party dominated and invariably governed through bipartisan grand coalitions. The independence of its Ministers, who were frequently the sole responsible for a determinate project, reflected the party's technocratic character. Their tendency to act unilaterally clashed against the consociational nature of Slovenian democracy. When the Slovenian Democratic Party seized power, former dissident Janez Janša departed from consensualism. The party confronted the trade unions and tried to dismantle existing socialist oligarchies. The endeavour failed yet claimed an illustrious victim: the LDS, which collapsed as soon as it was deprived of executive power. As for pensions, Slovenia experienced the enduring influence of the single-issue Democratic Party of Pensioners, which blocked, after 1999, any systemic rethinking of the Slovenian retirement system. Table V.3 and Table V.4 provide a summary of Slovenian parties and executives.

During the late 1980s, The League of Communists of Slovenia (ZKS) presented itself as a reformed communist party capable of decentralisation, market reforms, and resisting Belgrade's attempts to stop liberalisation. As multiparty politics were allowed, the six-party coalition Democratic Opposition of Slovenia (Demos) emerged. Under the leadership of Lojze Peterle, Demos won the founding elections, forming the first non-socialist Slovenian government. Notwithstanding, the Party of Democratic Renewal, the successor of ZKS, mustered considerable support and secured Milan Kučan as President of Slovenia for two terms, guaranteeing cohabitation.

Demos led Slovenia to independence, won the short war against the Yugoslav People's Army and obtained international recognition. Despite these achievements, factionalism and

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disagreement plagued Peterle's government: Finance Minister Marko Kranjec and Economic Minister Jože Mencinger resigned in opposition to privatisation plans. Internal contradictions led to the coalition's self-destruction in December 1991.

The second parliamentary election witnessed the return of the Left. By 1993, a grand coalition took power under PM Janez Drnovšek's leadership. The Liberal-democratic Party was heir to the League of Socialist Youth of Slovenia, which represented the opposition from within the regime during socialism. LDS became the politically most important entity in Slovenia and retained power almost uninterruptedly until 2004. Drnovšek himself served as Premier during 1992-2002, apart from a few months in 2000, when a centre-right coalition governed after a constructive vote of confidence. During those twelve years, LDS consolidated the Slovenian economy and politics, and led the country to EU membership.

If the alliance within the Left was not idyllic – the United List of Social Democrats abandoned the second Drnovšek government in 1996 after a row on pensioner rights and social expenditures – the relationship with the New Right was a nightmare. The Social Democratic Party of Slovenia (precursor of SDS) left that same coalition in 1994, after its leader and Minister of Defence Janez Janša was dismissed following a scandal. Similarly, Premier Anton Rop discharged the populist People's Party (SLS) ten years later.

By that time LDS was accused of clientelism, corruption and questionable appointment of cadres (Finance, 12 October 2004). The Slovenian political landscape changed dramatically after the October 2004 elections. After serving a fourth term as Premier, Drnovšek was elected President in December 2002. Finance Minister Rop became the new PM *ad interim*. LDS suffered from accession fatigue and failed to prepare for the 2004 elections. Consequently, the conservative coalition led by the Slovenian Democratic Party secured a neat majority in the National Assembly, partly owing to the political capital of its leader Janez Janša.

Despite various accomplishments, such as the adoption of the Euro and a relatively trouble-free Presidency of the European Council, the increasingly conservative and autocratic Janša was defeated in 2008. The new Premier, Borut Pahor, led the Social Democrats from marginal successor of the League of Communists to most powerful party in the country. Due to its individualistic nature, LDS almost disintegrated after 2004. The party is now a junior partner playing a minor role in government.

Finally, it is fundamental to mention the Democratic Party of Pensioners of Slovenia, which took part in all coalition governments since 1997 (in 2000 it gave external support to Premier Andrej Bajuk). Such endurance qualifies it as the most successful pensioner party in the world. Owing to its presence, significant changes in the country's retirement system were often precluded.

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Table V.3 Party system in Slovenia (after 2008 elections)

Party family affiliation	Acronym	Party name	Ideological orientation	Establishment and merger details	Foundation
Right	SNS	Slovenian National Party (*Slovenska nacionalna stranka*)	Radical nationalist		1991
Centre-right	SDS	Slovenian Democratic Party (*Slovenska demokratska stranka*)	Liberal conservative	Successor of Slovenian Democratic Union (SDZ – *Slovenska demokratična zveza*). Until 2003 known as Social Democratic Party of Slovenia (SDSS –*Socialdemokratska stranka Slovenije*).	1989
Centre	SLS	Slovenian People's Party (*Slovenska ljudska stranka*)	Agrarian populist	Successor of Slovenian Agrarian Union (SKZ – *Slovenska kmečka zveza*). Merged with Slovenian Christian-democrats (SKD – *Slovenski krščanski demokrati*) in 2000, SLS+SKD. This split into SLS and New Slovenia – Christian People's Party (N.Si – *Nova Slovenija – Krščanska ljudska stranka*). Ran the 2008 election in coalition with Youth Party of Slovenia (SMS – *Stranka mladih Slovenije*).	1905, banned in 1945, re-established 1992
Left	LDS	Liberal Democracy of Slovenia (*Liberalna demokracija Slovenije*)	Social liberal	Successor of League of the Socialist Youth of Slovenia (ZSMS – *Zveza socialistične mladine Slovenije*) as the Liberal-democratic Party (LDS – *Liberalno demokratska stranka*). Renamed and merged in 1994 with Democratic Party of Slovenia (DSS – *Demokratska stranka Slovenije*), Socialist Party of Slovenia (SSS – *Socialistična stranka Slovenije*) and Greens – Ecological-social Party (ZESS – *Zeleni – Ekološko socialna stranka*).	1990
	SD	Social Democrats (*Socialni demokrati*)	Social-democratic	Successor of League of Communists of Slovenia (ZKS). Renamed in 1990 into Party of Democratic Reform (SDP – *Stranka demokratične prenove*). Merged in 1993 with parts of DeSUS, Socialist Party of Slovenia (SSS – *Slovenska socialistična stranka*), Social Democratic Union (SDU – *Socialdemokratska unija*), Workers' Party of Slovenia (DSS – *Delavska stranka Slovenije*) into United List of Social Democrats (ZLSD – *Združena lista socialnih demokratov*). Renamed into SD in 2005.	1993
	Zares	For Real – New Politics (*Zares – Nova politika*)	Social liberal	Founded by runaway LDS members.	2007
Pensioners	DeSUS	Democratic Party of Pensioners of Slovenia (*Demokratična stranka upokojencev Slovenije*)	Single-issue		1991

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Table V.4 Slovenian executives

Date of change in political configuration	Presidential election date	President (party)	Presidential majority decisive round	Election date	Start of government	Head of government (party)	Governing parties (seats)	Govt majority (% seats)	Govt electoral base (% votes)
				08.04.1990	16.05.1990	Lojze Peterle (SKD)	Demos: SKD (11), SKZ (11), ZL (8), SDZ (8), SDZS (6), SOS (3)	58.8%	54.8%
14.05.1992					14.05.1992	Janez Drnovšek (LDS)	LDS, SDSS, SDP, ZS, SSS, DSS		
23.12.1992	06.12.1992	Milan Kučan (independent)	64%						
25.01.1993				06.12.1992	25.01.1993	Janez Drnovšek (LDS)	LDS (22), SKD (15), ZLSD until 31.01.1996 (14), SDSS until 29.03.1994 (4)	61.1%	54.9%
27.02.1997				10.11.1996	27.02.1997	Janez Drnovšek (LDS)	LDS (25), SLS (19), DeSUS (5)	54.4%	50.7%
	23.11.1997	Milan Kučan (independent)	55.6%						
07.06.2000					07.06.2000	Andrej Bajuk (SLS+SKD & N.Si)	SLS+SKD (28), SDS (16)[1]	51.1%	
30.11.2000				15.10.2000	30.11.2000	Janez Drnovšek (LDS)	LDS (34), ZLSD (11), SLS+SKD (9), DeSUS (4)	64.4%	63.0%
					19.12.2002	Anton Rop (LDS)	LDS (34), ZLSD (11), SLS until 20.04.2004 (9), DeSUS (4)	64.4%	
22.12.2002	10.11.2002	Janez Drnovšek (LDS, GPR[1])	56.5%						
03.12.2004				03.10.2004	03.12.2004	Janez Janša (SDS)	SDS (29), N.Si (9), SLS (7), DeSUS (4)	54.4%	49.0%
23.12.2007	21.10.2007	Danilo Türk (independent)	68.0%						
21.11.2008				21.09.2008	21.11.2008	Borut Pahor (SD)	SD (29), Zares (9), DeSUS (7), LDS (5)	55.6%	52.5%

Source: Državna volilna komisija (http://www.dvk.gov.si/). [1] Two additional members: DeSUS (1), SNS (1).

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Interest groups

In contrast to fragmented political parties and weak executives, the social partners strengthened during transition. Slovenian trade unions probably secured the firmest labour institutionalisation in Central, Eastern and Southeastern Europe. Not only do they play a role as civil society organisations, they also stand for those elite welfare stakeholders that originate in the state bureaucracy. Public employees rely on labour unions for representation and these enjoy a co-managing position in the Institute for Pension and Invalidity Insurance (ZPIZ). As for private pension provision in Slovenia, although the financial industry lobby did not match the strength of its Hungarian counterpart, it nonetheless played a significant role in the shaping of policy.

After trade union pluralism started in 1990, the labour movement split along the pro- and anti-communist cleavage (see Table V.5). The successor union ZSSS retained between one third and half of the labour force. Demos created Independence, which naturally stuck with the New Right, but lost many of its members. Pergam and Konfederacija '90 were left-leaning, but distanced themselves from ZSSS. Much later, in 2006, seven public employee trade unions, including the largest Education, Training and Science Union (SVIZ), formed the Confederation of Trade Unions of the Slovenian Public Sector (KSJS). Despite steady erosion, Slovenia retained one of the highest union densities in the region: 44.3% in 2003, down from two thirds in the mid 1990s.

During these two decades, ZSSS maintained its primacy. Before changing the statute, it had formal ties with the United List of Social Democrats, as the union's longstanding president Dušan Semolič appeared on the party's list. Politicians often considered ZSSS as the carrier of ZLSD interests, which made agreements difficult to reach (similar considerations hold for SVIZ/KSJS).

Table V.5 Trade unions and membership (2004 and latest)[1]

Association of Free Trade Unions of Slovenia (*Zveza svobodnih sindikatov Slovenije*)	ZSSS	300,000
Confederation of Trade Unions of Slovenia Pergam (*Konfederacija sindikatov Slovenije Pergam*)	Pergam	87,000
Confederation of Trade Unions of the Slovenian Public Sector (*Konfederacija sindikatov javnega sektorja Slovenije*)	KSJS	73,000
Independence, Confederation of New Trade Unions of Slovenia (*Neodvisnost, Konfederacija novih sindikatov Slovenije*)	KNSS	40,000
Confederation of Trade Unions '90 of Slovenia (*Konfederacija sindikatov '90 Slovenije*)	Konfederacija '90	40,000

Source: European Commission (2008b: 176). [1]Lukšič (2003: 519) presents the figures for 1997: ZSSS – 435,816; KNSS – 196,000; Pergam – 87,627; Konfederacija '90 – 40,000.

The importance of social partners increased after the creation in 1994 of the Economic and Social Council (ESS – *Ekonomsko-socialni svet*) at the request of trade unions, the

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Associations of Employers of Slovenia and the Labour Ministry. It has 15 seats, five for each partner. Despite not being underpinned by any legal act, apart from government regulation, and despite initial disregard by government representatives, it wields disproportionate power. Since 1995, social partners draft every year or two a social pact outlining their mutual obligations and collectively negotiate economic, social and wage policy.[21] The ESS has a quasi-bargaining role and it became customary to only discuss in Parliament legislation that had already been debated within its premises (Skledar, 2002).

The 1992 Pension and Disability Insurance Act (Uradni list RS, 12/92) converted the Community for pension and disability insurance, the last self-governed community to operate in Slovenia, into the Institute for Pension and Invalidity Insurance. This marked a return to the pre-socialist Austrian and German traditions. ZPIZ is often described as a monolithic institution, because it is almost exclusively responsible for the retirement system (the Tax Administration collects contributions). The Institute enjoys relative autonomy, but is *de facto* subordinated to the Labour Ministry, so does not directly shape pension-related legislation (Stanovnik, 2002: 60). It is also characterised by extreme institutional continuity. Even though the Slovenian government approves the general director, Janez Prijatelj occupied the post for 26 years until 2005.

One of the bones of contention is the composition of the Institute's executive board and assembly. Management of ZPIZ became one major concern of Slovenian trade unions. The issue only slowly gained in prominence as trade unions and the government had a honeymoon period during early transition. After that, the board composition changed constantly: in 1994, 1996, 1999 and 2005. In his crusade against the socialist establishment, Janez Janša ousted the longstanding director Prijatelj and tried to shift the Institute's composition in favour of the government.

Finally, the financial service lobby emerged after voluntary private solutions became an attractive business. The most intense mobilisation happened during the creation of a mandatory supplementary scheme for public employees in 2003-2004. Not only did private providers long for a slice of the cake and insurance companies feared increased competition, but the state also wanted to increase its stake in institutional investment through the Pension Fund Management Company (*Kapitalska družba*, KAD).

Pensions

The pension system inherited by Slovenia after independence was based on a transposed version of the 1982 federal Pension and Disability Insurance Fundamental Rights Act.[22] The Act

[21] These contain only negotiating frames for key systemic laws, such as the Pension and Disability Insurance Acts.
[22] All federal legislation is common to the other ex-Yugoslav republics, including Croatia.

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was the final of a series of amendments following the Federal Constitution's departures from Marxism, the abandonment of central planning for self-management and the increased federalisation of Yugoslavia.

The Pension Act delegated the administration of retirement to the self-managed communities of interest, which had ample regulatory powers within federal guidelines. ZPIZ was never broken down to sub-republic levels (Böhm, interview) and, in contrast to Croatia, farmers and self-employed were fully integrated into the general scheme. Contribution financing became the norm during the 1970s. Moreover, the system was sufficiently individualised in that employers' contributions reflected the wages of single employees. In contrast to other post-socialist countries, where the demand for policy innovation stemmed from betrayed performance expectations, these two features prevented systemic breakdown and delegitimation in the eyes of the public.

In general, retirement was possible at any age with enough years of insurance. Early retirement was allowed already at age 50 for women and 55 for men with temporary reductions that were lifted once the normal requirement was met. The effective retirement age was low (less than 56 for old-age and 50 for disability pensions in 1990). Benefits were calculated according to a generous ten-best-year formula and the 1983 Pension Act introduced back payments for failed indexation during the time lag needed to obtain data on wages. This meant that at a time of falling real wages, which should have flattened the distribution of imperfectly indexed pensions, the relative income position of pensioners improved.

Indexation to net wages was a direct consequence of regarding pensions as remuneration for active labour participation in the past (Stanovnik, 2002: 21).[23] During transition, trade unions and the pensioners' party DeSUS appropriated the concept. Accordingly, the indexation problem continues to remain a major issue in Slovenian pension politics.

Of course, this generosity could not be sustained indefinitely, as Proposition 1 suggests. As the Slovenian retirement system was used as an extended social safety net during transition to protect redundant workers from destitution, refinancing met its limits in low economic competitiveness, and social democrats fiercely opposed further retrenchment. Hence, restructuring entered the agenda as soon as the political stalemate unblocked.

Crisis

The deteriorating economic situation in Yugoslavia and the build up of inter-republican tensions augmented the feeling that public pensions were a safe haven. The extension of

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coverage and lax eligibility requirements corroded the system throughout the 1980s. The Yugoslav collapse, and an additional series of *ad hoc*, transition-induced measures aimed at lessening the population's malaise generated a run for pensions during 1990-1992. In just five years, the beneficiaries of disability benefits increased by almost 18%.

If the rise in the ratio of pensioners to workers seems less dramatic than in other transition economies, Stanovnik (2002: 28) points out that the introduction of new marginal contributors (the unemployed and those voluntarily insured) kept the dependency ratio artificially low since 1992. Not only did the average retirement age of new pensioners decline until 1994-1995, expenditures and budget transfers also soared. As pension-related deficits exceeded 4% of GDP already in 1997, the long-term fiscal prospects of ZPIZ became a major cause for concern. Table V.6 provides a summary of the crisis.

Table V.6 Slovenian pension crisis characteristics

	Pension expenditure /GDP	Pension revenues /GDP	Pension balance /GDP	Number of pensioners	Number of insured	Contribution rate	Replacement rate
Effect	**Increased from below 9% of GDP in 1989 to more than 14% after 1993.**	**Roughly matching expenditures until 1996, slowly declining to 9% of GDP since.**	**Almost balanced until 1996, budget transfers reached 4.0% of GDP soon after.**	**Increased by 25.6% during 1990-1999.**	**Fell by almost 10% in ten years.**	**Grew until 1996, when employer contributions were cut.**	**Declined from 89% in 1990, and stabilised at around 75% of average wages during the decade.**
Cause	High benefits, indexation to net wages, worsening SDR and introduction of health insurance.	Drastic cut in contribution rates.	Refinancing was discontinued, hence, ZPIZ became dependent on state subsidies.	Disability shot up by 19%, old-age pensions by almost 40%. Early retirement laws triggered a run for pensions in 1990-1992.	Personalisation of the system helped to mitigate the fall.	Concerns about international competitive-ness.	The decline in 1991 followed the capping at 85% of the ratio between average wages and old-age pensions.

[23] The 1992 reform substituted this contested concept. Pensions are granted on the basis of work, a notion that lies at the heart of any Bismarckian system (Prijatelj, 1996: 71-72). National pensions, introduced in 1999, marked a move towards universalism.

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Table V.7 Economic and pension system indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
ZPIZ outlays as % of GDP[1]	-	-	13.8	14.0	14.4	14.7	14.5	14.4	14.3	14.4	13.3	13.2	13.2	13.0	12.8	12.8	12.4	11.8
o/w covered by contributions[1]	-	-	13.5	13.9	13.1	12.9	11.0	10.1	10.2	9.9	9.1	9.2	9.1	9.0	9.0	9.0	8.8	8.6
o/w covered by budget transfers[1]	-	-	0.0	0.5	1.0	1.0	2.7	4.0	4.2	4.3	3.8	4.0	4.2	4.0	3.9	3.8	3.6	3.2
SDR – Insured to pensioners	2.30	1.95	1.70	1.71	1.69	1.67	1.65	1.67	1.66	1.68	1.74	1.71	1.64	1.61	1.60	1.59	1.59	1.62
SDR – Pensioners to insured	0.43	0.51	0.59	0.58	0.59	0.60	0.61	0.60	0.60	0.60	0.57	0.58	0.61	0.62	0.63	0.63	0.63	0.62
Age Dependency Ratio (15-64/65+)	16.3	16.6	17.0	17.4	17.8	18.2	18.5	18.9	19.3	19.7	20.2	20.6	21.0	21.5	21.9	22.2	22.5	-
Net replacement rate	89.2	73.8	78.4	74.5	77.2	77.9	75.8	75.4	75.6	76.8	76.1	73.8	73.3	71.5	70.6	69.8	69.2	67.4
Insured	885	817	765	783	773	769	766	783	784	800	839	841	837	834	837	843	855	879
Insured in KAD															165	169	175	181
Beneficiaries	384	419	449	458	458	460	463	468	472	476	482	492	509	518	524	531	537	543
o/w old age	-		249	256	257	259	262	267	271	276	282	288	295	302	308	315	323	333
o/w disability	-	-	92	94	95	96	97	97	97	97	98	98	98	97	97	97	96	95
o/w survivors	-	-	79	80	81	82	83	85	86	87	88	89	91	92	93	93	92	92
Unemployment	-	7.3	8.3	9.1	9.1	7.2	6.9	7.1	7.4	7.4	6.4	6.9	6.5	6.7	6.4	7.2	5.6	4.7
GDP growth	-7.5	-8.9	-5.5	2.8	5.3	4.1	3.7	4.8	3.9	5.4	4.1	3.1	4.0	2.8	4.3	4.3	5.9	6.8
Inflation	551.6	115.0	207.3	32.9	21.0	13.5	9.9	8.4	8.0	6.2	8.9	8.4	7.5	5.6	3.6	2.5	2.5	3.6
Wage growth	379.6	65.4	205.0	47.2	25.3	18.4	15.3	11.7	9.6	9.6	10.6	11.9	9.8	7.5	4.4	4.9	4.8	5.9
Budget balance	-	2.6	1.2	0.9	0.0	0.0	0.3	-1.1	-0.7	-0.6	-3.7	-4.0	-2.5	-2.7	-2.2	-1.4	-1.2	0.5
Public expenditure	-	41.1	44.1	45.5	44.9	54.0	45.6	46.1	46.9	47.8	46.7	47.6	46.3	46.4	45.8	45.2	44.5	42.1
Public debt	-	-	45.6	21.1	18.5	17.4	21.0	21.4	23.4	24.6	27.1	27.3	28.0	27.5	27.2	27.0	26.7	23.4
C/A balance	49.6	7.1	16.8	2.7	6.3	-0.5	0.3	0.3	-0.7	-4.1	-3.2	0.2	1.1	-0.8	-2.7	-1.7	-2.6	-4.2
External debt	186.9	103.2	31.6	26.7	47.9	42.6	46.5	46.9	44.3	49.0	51.4	50.3	55.6	58.9	62.3	70.6	81.4	108.5

Source: *Kapitalska družba* (KAD), Statistical Office of the Republic of Slovenia (SURS), Institute for Pension and Invalidity Insurance (ZPIZ). ADR: HNPStats (World Bank). Economic indicators: European Bank for Reconstruction and Development (EBRD) (http://www.ebrd.com/country/sector/econo/stats/sei.xls). [1]Stanovnik and Vezjak (2004: 250), RS Finance Ministry (2008: 52-53) for data after 2000.

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Early responses

In order to dampen the emergency, Slovenian policymakers rather unsuccessfully tried out a mixture of all available expedients: the 1992 and 1996 Pension and Disability Insurance Acts contained retrenchment, refinancing and restructuring measures.

To keep pension expenditures under control, wage indexation froze during 1990-1991. This violated the horizontal equity of the system (between different cohorts), so a complex valorisation formula was introduced in 1992 (Stanovnik, 2007: 6-7). Additionally, the benefits for a full pension qualifying period were limited at 85% of the pension base. The two retrenchment measures resulted in a visible reduction in replacement rates, as indicated in Table V.7.

These unjust measures elicited much discussion within the Executive council, the interim government led by Lojze Peterle, which planned some structural changes. However, due to internal disagreement (the Grey panthers, a pensioner party that merged with LDS, even drafted a proposal of their own) and bad experience with the final amendments in 1983, the 1992 Pension Act did not live up to expectations. The package had even temporary status, as the National Assembly required further restructuring to be carried out within two years. Apart from amendments in 1994 and 1996, almost eight years passed until the next reform.

Stanovnik (2002: 26) described the 1992 package as *"too little, too late"*, since it was legislated when the phase of *"political and economic uncertainty, recession and high inflation"* (Kračun, 2006: 309) was over. Its resemblance to the 1983 predecessor shows a lack of inventiveness. The Act was designed to deal with too many things at once. It aimed to create a purely Slovenian legal framework to social protection, to strike a balance between the financial troubles of the public system and the increased demands of pensioners and, finally, to substitute the self-managed system with an organisational structure compatible with a market economy (Prijatelj, 1996: 36). Its achievements were mixed.

On the negative side, policymakers retained the old habit to overspend. Indexation remained wage-based, the purchase of school and army years was allowed, as well as the possibility by employers to secure up to five years of additional contributions for their employees in case of termination, restructuring and bankruptcy. Coupled with lax early retirement rules, these measures represented the most expensive way of dealing with excess labour (Prijatelj, 1996: 199). Since the unimpressive reform did not stabilise expenditures, contribution rates increased until 1995, as shown in Table V.8. By then, ZPIZ had already wiped out its reserve fund, whereas in 1993 it still financed both the budget and the Institute for Health Insurance of Slovenia, ZZZS (Finance, 17 January 1996; Stanovnik, 2002: 28-29).

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Table V.8 Pension insurance contributions 1989-2008

	1989	1990	1991	1992	1993	1994	1995	1996	1997-2008
Employer	3.45	3.62	14.4	14.4	15.41	15.5	15.5	11.07	8.85
Employee	19.1	19.1	14.4	14.4	15.41	15.5	15.5	15.5	15.5
Total	22.55	22.72	28.8	28.8	30.82	31	31	26.57	24.35

Source: Stanovnik and Stropnik (1999: 12).

On the positive side, eligibility criteria became stricter. The conditions for acquiring the right to old-age pensions were restricted and extended to workers with a full pension qualifying period (see Stanovnik, 2002: 32-33). Possibly, the reform also stopped workers from other ex-Yugoslav republics securing a pension from ZPIZ (Böhm, interview).

The 1992 Pension Act introduced several structural innovations. The Institute for Pension and Disability Insurance substituted the relative self-managed community, it became responsible for the Capital fund of pension and disability insurance and the Supplementary pension insurance fund (the first funded elements to enter the generational solidarity system), and voluntary funded schemes were introduced. Moreover, the government endowed the Capital and Housing funds with assets, hoping to lessen the long-term contributory burden.

The Capital fund started to manage resources deriving from three sources: 10% of not yet privatised former state-owned enterprises, direct investments by physical persons and nationalised assets of workers insured in Yugoslavia and never indemnified. The Capital fund had to use dividends, interests and other revenues to finance public pensions or recapitalise the fund. The latter was converted in December 1996 into an independent joint-stock company, the Pension Fund Management Company (*Kapitalska družba*, KAD), whose sole owner became the Republic of Slovenia (Statut KAD, 2004). This led to the systematic decapitalisation of KAD to finance growing ZPIZ deficits, breaching the original intention to subtract these means from political abuse, but also lessening the pressure on the state budget (Prijatelj, 1996: 77). The Supplementary pension insurance fund was established in 1995, but never took off. Lacking sufficient tax incentives, the fund attracted only a few hundred members (Finance, 22 May 1998). The scheme generated conspicuous losses and got converted into a joint-stock company in 1998. KAD longed for co-ownership and ultimately obtained it.

Voluntary supplementary pension insurance had to be regulated by a never-enacted special law. The legislator contemplated both occupational and individual schemes. Insurance companies, firms and ultimately the ZPIZ were designated as possible providers. The inclusion of ZPIZ was not planned beforehand; hence, the discussion in the Assembly yielded unsatisfactory provisions. Overall, the 1992 Act timidly attempted to introduce private pension insurance, yet the failed adoption of necessary regulation and specific tax exemptions resulted in little interest shown for these schemes.

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Firms were already paying disproportionately high contribution rates, peaking at 44.7% in 1995, and were therefore uninterested in collective provision without tangible financial advantages. As for insurance companies, only three entered the unattractive business: Slovenica, Concordia and Zavarovalnica Triglav (the major Slovenian insurance company). Their pension plans had to be based on the Insurance Companies Act. This equalised the premia paid for voluntary pensions to all other social security payments. Pension insurance was therefore disadvantaged with respect to life insurance, which in the event of death granted higher benefits to heirs. As insurance companies were the sole providers, they gathered a few thousand voluntary pension members against 350 thousand life insurance contracts (Finance, 7 June 1999). In order to increase the attractiveness of pension schemes, Concordia offered perks in the form of cheaper loans (Finance, 29 March 1995), and found a system to avoid taxation on premia. This was inconceivable at the time, and the Finance Ministry, extremely disinclined to tax exemptions, suffocated the endeavour (Kalčič, interview).

Reaction

Although the pension system held during transition, policymakers were aware of the need for paradigmatic reforms ever after the adoption of the 1992 Pensions Act. Proposition 1 argues that once policymakers cannot enact simple corrective measures, such as retrenchment and refinancing, they start considering more fundamental restructuring. Systemic reforms took in Slovenia a slightly different course. Whereas refinancing became unsustainable due to excessive non-wage labour costs, benefit cuts entered the agenda during the mid-1990s. The mild retrenchment measures contained in the 1996 Pensions and Disability Insurance Act (Uradni list RS, 7/96) elicited such harsh disagreement that the government was forced to play the restructuring card. The existence of a very strong pro-welfare coalition and many (especially corporatist) elite welfare stakeholders implied that a complex negotiated bargain was a *conditio sine qua non* to reach agreement.

The 1996 amendment introduced eligibility restrictions and less favourable indexation. Back payments were abolished and pensions were indexed to net wages only in case of positive cumulative growth. During real falls in wages, pensions would maintain their nominal value. Reduced pension rights, based on lower contribution rates, were eliminated. The act dealt with low contributions by the self-employed, one major weakness of the public pillar.[24] The 1996 amendment raised the contribution base, often equal to the lowest collectively bargained wage, and elongated the calculation period to those years when the self-employed were totally free to

[24] In 1996, the self-employed represented 14.1% of all the insured. They contributed only 6.3% to the mass of contributions flowing into ZPIZ, i.e. less than half the average paid by employees in enterprises.

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set the contributed amount (Ministry of Labour RS, 1996: 71). The latter provision was unsuccessfully challenged in front of the Constitutional Court (Finance, 11 December 1996). Finally, the act converted ZPIZ funds into separate legal entities. The Capital fund underwent proper renationalisation: not only was it transformed into a state-owned joint-stock company, but the National Assembly also started to nominate its governing bodies. This deprived the ZPIZ, and hence trade unions, of any influence over its management, and prevented the creation of a common legal entity administering all the Institute's funds (Finance, 31 January 1996).

The United League of Social Democrats, which treated the Ministry for Labour, Family and Social Affairs as its personal fiefdom, disagreed on the future composition of ZPIZ's assembly and changes in the indexation formula. The nationalisation of KAD enraged ZLSD Labour Minister Rina Klinar. As a result, the Social Democrats abandoned the executive in January 1996. The Act passed despite the narrow majority, a National Council veto, and the threat by pensioner associations to hit the streets (Prijatelj, 1996: 39-40; Zajc, 2002: 71-72). After the rupture, Premier Drnovšek expressly appointed new Labour Minister Anton Rop, LDS's rising star and former state secretary for privatisation, to reform the ailing pension system.

This completely changed the government's reformist attitude, since Rop invested most of his future political career in the endeavour (Finance, 5 May 1999; cf. Guardiancich, 2004). The economic environment was relatively favourable to reforms: Kračun (2006: 309) describes 1993-1997 as the period leading *"from recession to steady growth"*. Stabilisation started to yield results and Slovenia maintained low public debt and current account deficits during a time of relatively strong economic expansion.

Restructuring

Even before the appointment of Rop, a joint IMF and World Bank mission provided the supply for policy innovation. This prepared the 1995 report 'Republic of Slovenia: New Challenges Confronting the Social Insurance System' (IMF, 1995). The report favoured more retrenchment and voluntary funded elements, recommending a two-stage approach (parametric reform followed by structural changes) due to the missing preconditions for swift privatisation. The involvement of Bretton Woods institutions and Rop's nomination elicited a swift response. A working group at the Labour Ministry drafted by July 1996 the 'Starting points for the reform of the pension and disability insurance system', in collaboration with the *crème* of Slovenian social security experts. The report endorsed a multipillar reform concept.

That year's elections upset the ambitious decision-making schedule, which foresaw parametric reforms already in 1997. Lengthy negotiations produced the coalition between LDS,

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the Slovenian People's Party and DeSUS. The reappointment of Rop as Labour Minister strengthened his determination to carry out pension reforms. In May, a roadmap for the 'White Paper on the Reform of the Pension and Disability Insurance in Slovenia' was drafted under Phare guidance. The document saw the light in November 1997 as the government's official proposal. No other group handed in any alternatives.

Theoretically, the conditions for Proposition 2 to apply to Slovenia were ideal. The proposition claims that systemic innovations open up greater room for manoeuvre for policymakers, who can trade them for deeper parametric cuts. Since Minister Rop reprised 'Averting the Old-Age Crisis' in the 'White paper', its conversion into law was foreseeable. As both international and domestic experts agreed on a multipillar system, its partial demise came as a surprise. Two intertwined explanations may be put forward: the divisive policymaking style of Labour Minister Rop that clashed with consensual decision-making in Slovenia, and earlier policy measures which tipped the balance against a mandatory funded pillar (Stanovnik, 2002; Guardiancich, 2004).

Already in its opinions on the 'White paper', the union ZSSS deplored the way Rop was forcing the pace of reforms (Vlada RS, 1998). During the first round of negotiations, the Labour Minister created a tripartite working group to shorten the lengthy procedures involving the Economic and Social Council. Rop was attacked from every front for the introduction of a mandatory funded pillar. Given that contribution rates were significantly reduced in 1996, partial privatisation was condemned as fiscally unfeasible.

The relations with trade unions soured to the extent that by February 1998 they did not even consider the draft 'Social agreement on pension reform' (Stanovnik, 2002: 44). The massive strike on 28 March 1998 dealt the final blow to Anton Rop's political capital. Popular demand for policy innovation, which until then underpinned the executive's efforts, waned. In April 1998, whereas 61% of the surveyed were in favour of pension reforms, as many as 55% opposed the solutions proposed in the 'White paper' and 76% opposed an equalised full retirement age of 65 (Finance, 29 April 1998). Partial privatisation slipped off the agenda. Social partners were urged to present their alternative positions and draft a social pact on pension reforms, as required by the Economic and Social Council. This represented the official start of concerted policymaking.

It took one year (from May 1998 until April 1999) to sign two social agreements, one with employer associations and one with the four trade union confederations (Finance, 30 April 1999). ZSSS was once more the problem, and Rop tried to circumvent the union by offering separate agreements to the other confederations. PM Drnovšek himself deemed this unacceptable and exhorted the parties to reach a compromise. Numerous rounds of tough negotiations within a

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new tripartite body, the coordinating working group, followed the draft 1999 Pension and Disability Insurance Act.

Although the draft already watered down many parametric changes contained in the 'White paper', ZSSS repeatedly threatened to call a referendum and overturn prospective reforms. Further concessions broke the stalemate. The National Assembly voted the Pension and Disability Insurance Act on 23 December 1999 (Uradni list RS, 106/99). It entered into force already in January 2000.

Policy trade-offs

Ever since the 1995 IMF report, Slovenian policymakers longed for a partially privatised multipillar system. The main objectives were to achieve greater efficiency through private schemes, reconcile lower contribution rates, improve Slovenian international competitiveness and improve the financial viability of public pensions. Hence, the IMF recommended to render the public system sustainable, to develop financial market institutions, and to earmark part of the privatisation assets to reduce implicit liabilities. The report did not back any specific multipillar arrangement.

The 'Starting points' replicated IMF's position and endorsed a reform in three stages: the 1992 and 1996 Pensions Acts represented the first one. The elimination of privilege and unwarranted redistribution, as well as a tighter contribution-benefit link would follow. Finally, a multipillar system that included a mandatory funded pillar guaranteed by the state would be completed by 2001 (Ministry of Labour RS, 1996: 69-74).

The 'White paper' was a more elaborate document. It depicted a grim no-reform scenario, where ZPIZ would generate deficits of up to 15% of GDP by 2040 (Ministry of Labour RS, 1997: 132). The document continued to be vague with respect to the multipillar structure. It neither specified whether the public PAYG pillar should use a point formula, nor did it suggest a contribution rate for the funded pillar. Among other things, it envisaged the swift introduction of equalised eligibility criteria for men and women, full retirement age of 65 by 2022 with bonuses and maluses, and the elongation of the calculation period from 10 to 25 years, none of which pleased the Association of Free Trade Unions.

Plainly, the 'White Paper' was not a good starting point for negotiations. Its radicalism, foreclosed the constructive employment of the trade-offs envisaged by Natali and Rhodes, which would have helped overcoming the resistance of the pro-welfare coalition. The credit-claiming potential that could be, according to Proposition 2, traded for benefit reductions was never used. Even the possibility of setting up its own pension schemes and receiving a substantial Structural Adjustment Loan, promised by the World Bank, did not soften the pro-welfare coalition's stance

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(Böhm, interview). The stubbornness is best explained by ZSSS's (and limitedly of DeSUS) fear of a 'hidden agenda' behind the introduction of a mandatory funded pillar (Stanovnik, interview). The diversion of contributions would have created deficits in the public pillar to be financed with further cuts.

Excessive optimism regarding the financing of transition, the coverage of a mandatory funded pillar and the vague institutional structure drew widespread criticism. The polemic became harsher at the height of the dispute between the unions and the executive (Finance, 3 April 1998). The World Bank commissioned a paper to Velimir Bole, Slovenia's most respected economist. The document opposed partial privatisation and convinced Finance Minister Mitja Gaspari that transition costs would lower the controllability of the government's general fiscal position. Hence, a multipillar system consisting of only a first public and a third voluntary funded pillar would be more sustainable (Bole, 1998: 21). As expected, the reaction of World Bank officials, for example Roberto Rocha, was negative and, once Rop shelved the mandatory pillar, funding of pension-related activities ground to a halt (Finance, 3 April 1998).

In a last attempt to solve the financing problems of the mandatory pillar, Rop tried to bundle together pension reforms and the introduction of a single VAT rate. The whole plan was spoiled due to policy legacies: the huge ZPIZ deficits, generated by a 6.65% reduction in employers' contributions in 1996; the reduction in custom duties (1.1% of GDP), due to the signing of the European Association Agreement in 1996; and the elimination of the tax on consumption (13.4% of GDP), to be compensated by the introduction of VAT, precluded such improvised solutions (Finance, 29 April 1998). Both the second pillar and the unified VAT rate slid off the agenda. Greater efficiency and the possibility to develop the Slovenian capital market were sacrificed for financial viability.

From then on, negotiations finally traded some of Natali-Rhodes' dimensions against each other. Parametric changes in the public pillar were sweetened by strong tax incentives to voluntary private schemes. The rationale behind the Exempt Exempt Taxed (EET) treatment was the expansion of supplementary retirement provision beyond the coverage of life insurance schemes (available to every fourth household). Trade union demands for a *quid pro quo* coincided with Rop's plan to build the necessary infrastructure to one day upgrade the voluntary to a proper mandatory funded pillar (Finance, 22 May 1998).

A compromise on parametric changes was reached with the introduction of bonuses and a more nuanced scale of maluses. The full retirement age fell from 65 for all to 63 for men and 61 for women. The entry pension after 15 years of qualifying period was increased and differentiated by gender. The calculation period for the pension base was shortened from 25 to 18 years.

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In addition to ‘general’ compensation, several elite welfare stakeholders were entirely excluded from reforms. Special laws continue to regulate budget-financed pensions for Second World War veterans, policemen, customs officers. Those categories that qualified for an insurance period with bonus (up to 18 months per year) were instead guaranteed participation in the Compulsory Supplementary Insurance Fund, a small state-run funded scheme. Contributions are entirely paid by employers and are at least equal to the aforementioned bonus.

The unions (and ZLSD) obtained several important policy concessions that reduced overall retrenchment and maintained several redistributive elements. Of course, the trade-off underlined in Proposition 3 worsened considerably. Against the background of greater-than-planned generosity, fiscal viability was ensured only in the short- and medium-term, thereby postponing tougher decisions for a decade. Table V.9 summarises policy differences between proposal and output.

Table V.9 Policy compromises

	Reform proposal	**Reform output**
First pillar		
Retirement age	65 for all	61 for women and 63 for men
Benefit formula	32.5% of the assessment base for all for first 15 contributory years	38% for women and 35% for men for first 15 contributory years
Bonuses/maluses	0.3% for each month missing/added to the retirement age, 0.5% added after 65	More nuanced scale: maluses up to 12% and bonuses up to 7.2%
Assessment base	Average wage during 25 best years	Average wage during 18 best years
Second pillar		
Contribution rate	6%	Repealed

Political trade-offs

Negotiated bargains have multiple objectives and can be qualitatively very different from one another, as Proposition 4 posits. Limited bargaining and divisive policymaking that lead to the uneven allocation of gains and losses require specific political-institutional structures to be feasible. Since Slovenia is a consensual democracy, its decision-making process is disseminated with balancing mechanisms that policymakers cannot circumvent to impose particular reforms. Minister Anton Rop learned this the hard way. The appointment of an economist to the Ministry of Labour, the full responsibility enjoyed by Slovenian Ministries for any given project, and the decentralised nature of LDS, a party where individualism predominates, determined Rop’s decision-making style. He opted for a confrontational rather than consociational approach to pension reforms.

By prioritising the paradigmatic shift to private provision at all costs, he not only created a deep cleavage between the government and civil society, but also jeopardised his own career and the coalition’s future. The Labour Minister neither heeded the recommendations of a Phare team, which criticised the ‘Starting points’ (Stanovnik, 2002: 44), nor included trade unions in

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the key drafting phases of the 'White paper'.[25] Keeping ZSSS out was an unforgivable *faux pas* and allowed trade unions to justify their rational opposition against cutbacks and irrational opposition against the mandatory funded pillar (Finance, 24 September 1997).

The Association of Free Trade Unions did not have a proposal of its own. Notwithstanding, it wielded a *de facto* veto on legislation related to social policy. The Labour Minister firmly believed that ZSSS was the transmission belt for the preferences of opposition party ZLSD, and this elicited the Minister's excessive antagonism (Böhm, interview). Nonetheless, Rop (interview) claims that he deliberately presented a radical proposal to gain negotiating ground vis-à-vis the social partners. However, subsequent conduct points to protracted unilateralism. The Labour Minister tried to play the 'new' labour federations against the 'old' trade union, albeit with minimal success. Just before total breakdown, he backed off from the most radical proposals, thereby attracting the criticism of employer associations (Finance, 25 March 1998).

The retreat is perfectly understandable: failure of the reform process would have compromised the Minister's future office (Rop became Prime Minister in 2002) and would have had a negative impact on LDS's electoral results. Further dilution of the 1999 reform followed: the Labour Minister sacrificed his policy goals and started more constructive negotiations. The executive granted concessions to trade unions that went beyond favourable policy solutions. The office aspirations of ZSSS were fulfilled through the rebalancing of ZPIZ's assembly and executive board. The former had its members halved (from 60 to 30) and the unions' share increased from one sixth to almost one third.

In the political arena, Rop had to obtain the government's internal endorsement, which involved both taming the fiscal worries of Finance Minister Gaspari and fulfilling the demands of coalition partners DeSUS and SLS. Gaspari was initially absent from the reforms, due to the individualist character of Slovenian decision-making. Subsequently he became a passive player, and did not participate in the drafting of the 'White Paper', delegating the responsibility of transition financing to Rop. Gaspari intervened only when the stalemate between Rop and ZSSS was harshest, and opposed the second pillar at the last moment, after Velimir Bole's publication condemned the funded pillar (Guardiancich, 2004: 56).

As a *quid pro quo* for abandoning privatisation, Rop obtained favourable tax treatment for voluntary pensions. Gaspari claimed at first that exemptions for collective schemes were far too generous, since neither Corporate nor Personal Income Taxes and not even social

[25] The working group comprised experts from the Labour and Finance Ministries, ZPIZ, various faculties of the University of Ljubljana as well as Phare and World Bank officials (Ministry of Labour RS, 1997: 2). Social partners were not involved.

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contributions were levied from the employers' part. Consequently, the issue was removed from his competence by not preparing a separate law on supplementary pensions. Supplementary schemes were bundled together with the general law. Eventually Gaspari gave in, but the bundling of voluntary pensions remained.

Junior partners SLS and DeSUS also had to be granted policy concessions to keep their support in the National Assembly. The two parties' neutralisation required several amendments to the 1999 Pension Act. According to Stanovnik (2002: 44-45), indexation to wage growth and a legal obligation that the budget cover all ZPIZ deficits appeased DeSUS. SLS instead demanded and obtained a non-contributory national pension for its rural electorate, a unique feature in the region's pension panorama.

As for the opposition, the 1999 reform was sanctioned by only 50 MPs, i.e. the governing coalition with only one external endorsement. This result is misleading. On the one hand, opposition parties did not present any comprehensive reform alternatives. On the other hand, the former coalition partner ZLSD proposed various parametric solutions, which unblocked the political gridlock. This stood very much in contrast to its past stance, when the Social Democrats almost toppled the LDS-led coalition for tabling analogous proposals.

Finally, Slovenia experienced a lobbying effort by the financial sector. In particular, insurance companies felt threatened by the expansion of voluntary private pensions (Mramor, interview). So they demanded equal tax treatment for all types of savings for old age and simplified switching of assets between different schemes (Finance, 5 August 1998). The insurance sector did not obtain either, yet its later efforts secured advantages in the organisation of supplementary pension insurance (Finance, 10 July 2000). Insurance companies can use multiple channels to set up their own schemes and perform all of the administrative functions in house.

Kapitalska družba, a prominent elite welfare stakeholder, gained most from the 1999 Pensions Act. Anton Kožar, the fund's director, strictly collaborated with Rop and considerably expanded the institution's role (Finance, 26 November 1997). KAD was given the responsibility to manage: securities and other resources acquired during privatisation, the First Pension Fund (financed by unallocated privatisation vouchers), the Compulsory Supplementary Insurance Fund, and voluntary mutual pension funds. Finally, the *Kapitalska družba* became in 2004 a mandatory funded scheme for public employees. The following paragraphs explain this evolution.

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The creation of a quasi-mandatory pillar

The most important post-1999 development was the extension of supplementary pensions to public employees, as a complement to their public pillar benefits. The creation of this quasi-mandatory funded pillar helped the government to comply with its inflation target within the Maastricht criteria, ultimately contributing to the adoption of the Euro in January 2007. In line with Proposition 2, the systemic features of funding were instrumental to crafting a bargain with public employee trade unions. The deal was much simpler that a full-fledged pension reform, yet nevertheless involved some of the trade-offs envisaged in the Natali-Rhodes framework. Once more, the bargaining process shows that divisive policymaking is frequently an unavailable option in environments ripe with multiple checks and balances.

The reform was attempted in two steps. Anton Rop, the Finance Minister during 2000-2002, resorted again to unilateralism and failed. His successor, Dušan Mramor, adopted a different policymaking style. While the government drafted the master plan, a bilateral negotiating group, which comprised public trade unions and the government, hammered out the regulatory details. The selection of the provider was delegated to a smaller committee, whose composition reflected the negotiating group. Hence, the government engaged in extensive dialogue during most reform stages.

The bargain with public sector employees was relatively straightforward: de-indexation as well as negotiated public salary increases were traded for more favourable policy solutions, i.e. variable premia and greater tax exemptions, and fuller involvement of labour unions in the management and selection of the pension provider. The outcome is still regarded as a success.

Unilateral imposition

The need to comply with the Maastricht criteria gave additional impetus to pension reforms. Burdened with low public debt, low budget deficits and a relatively stable exchange rate, Slovenia nevertheless had the problem of reining in its inflation. This stemmed from the widespread contractual indexation of the Slovenian economy. Public employees, entirely financed by the budget, were granted salary increases via social pacts concerted at the ESS level (Stanojević, 2009). These hikes had a domino effect on wages, social contributions and ultimately pensions. Limiting at the source the snowballing phenomenon was one proposed measures to fight inflation.

After the brief interlude of Andrej Bajuk's conservative government, LDS won the November 2000 electoral bout. Anton Rop was appointed Finance Minister. His first move was to lower the indexation of pension benefits (still largely based on wages) in December 2000. Furthermore, Rop tried to convert the public administration's salary increase into premia flowing

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into supplementary pension schemes (Kalčič, interview). The public administration, including the judiciary, is the state's core working force, counting some 33 out of 160 thousand public employees. The government issued two decrees that regulated the conversion, scheduled to start in May 2002 (Uradni list RS, 37/02) The original plan was to select 5-7 supplementary pension providers via public tender and appoint a special commission chaired by state secretary Miran Kalčič (Finance, 10 June 2002). However, the criteria and number of funds were never spelled out, and supplementary pension providers were already hinting at possible unfair competition by the greatly reinforced *Kapitalska družba* (Finance, 10 June 2002).

After a long series of successful social pacts, Rop's legislative imposition was regarded as totally inappropriate. The Union of State and Social Organs (SDDO, *Sindikat državnih in družbenih organov Slovenije*) and part of the affected administration appealed to the Constitutional Court (Finance, 4 July 2002). The Court repealed the decrees amending the employment contract for public employees by arguing that they were contrary to the spirit of supplementary pension schemes, which are by nature voluntary (Uradni list RS, 60/02).

Negotiated bargain

The urgency to do something intensified in November 2002, after the European Commission labelled the Slovenian economic pre-accession program as not ambitious enough with respect to inflation (Finance, 22 November 2002). When Anton Rop replaced Premier Janez Drnovšek, who became President in December 2002, Dušan Mramor was appointed new Finance Minister. He disclosed the plans to de-index the Slovenian economy during his official presentation (Mramor, 16 December 2002). Part of his project involved the reprisal of Rop's initial endeavour.

The second attempt to convert salary increases into pension insurance premia followed a completely different course than the first one. Instead of limiting the quasi-mandatory pillar to the public administration, this reform round encompassed all public employees. Mramor proposed the conversion of the 2.4% public employees' salary increase scheduled for August 2003 into a uniform premium, payable from 2004 on (Finance, 10 June 2003). Concomitantly, the Minister for Internal Affairs Rado Bohinc had the task of presenting the deal to public sector trade unions.

Initially, the unions opposed the proposal by arguing that the premia were too low (Finance, 13 June 2003). Finance Minister Mramor unblocked the stalemate by linking these premia to the signature of the annexes to the collective agreement. Such a negotiated bargain was then used to simultaneously determine the indexation of public sector wages in 2004-2005 and the portion to be destined to private pension insurance (Pogačar, interview).

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An extenuating negotiation between public sector trade unions and the government started in June 2003. This came to a halt already in July and resumed only when the government offered more flexible policy options. As a further requirement, Branimir Štrukelj, president of the Education, Training and Science Union (SVIZ), demanded that trade unions co-manage the fund on equal footing with the government.

Since negotiations also had to determine the number of funds and their managers, existing providers started a ferocious media campaign against the proposal to institute a single close-end mutual pension fund for the whole sector (Finance, 30 June 2003, 1 July 2003). Representatives of smaller pension companies argued that competition would be hindered and that there was no justification for such solution, since the original Rop proposal foresaw more than one provider. Of the same avis was Alenka Žnidaršič-Kranjc (interview), director of the biggest voluntary pension fund Prva pokojninska družba, who stated that this would allow the state to concentrate all Slovenian wealth in its hands. Only *Kapitalska družba* managers agreed that the government had the right to establish its own fund, since it was also paying for it.

The denigratory campaign was so harsh that the bilateral group ceased to filter out further information on the course of negotiations (Böhm, interview; Finance, 14 July 2003). Ultimately, an agreement was reached, comprising both the conversion of salary increases into premia for 2003 and the indexation of public sector wages in 2004-2005 (Finance, 24 July 2003). Nonetheless, the success of these talks was uncertain until the last moment. The deal was hammered out with a razor-thin majority on the unions' side and the involvement of Premier Rop in the final stages of negotiation. Two policy concessions were fundamental for the unions' acceptance: the introduction of variable premia based on the insurance period and Finance Minister Mramor's proposal to completely exempt the premia from tax. In fact, they do not even count towards the ceiling to tax exemptions for individual pension insurance, which amounts to 24% of mandatory social security (first pillar) contributions.[26]

The two agreements were signed on 29 July 2003 (Uradni list RS, 73/03). However, the road to finalising the deal was a bumpy one, since there was a sequence of deadlines to be met (Pogačar, interview). The selection process of providers had to be collectively determined with trade unions by September 2003 and the ensuing special law regulating the collective insurance of public employees adopted shortly after. The selection of the provider and the conversion of salary increases into premia had to be carried out by April 2004.

By the end of September, it was finally decided that there would be only one close-end mutual pension fund, managed by one pension fund manager (insurance company, bank, pension

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[26] Such generosity represents, however, a threat for existing pension providers, who declared to be ready to sue the state if public employees start abandoning them.

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company or *Kapitalska družba*), with the possibility to contract out part of the management to other providers. This agreement was the result of a significant struggle between the government, which advocated a single pension fund, and trade unions. The latter were offered to choose the provider and its managers (Finance, 24 July 2003). As a result, public employee trade unions abandoned the idea of establishing their own pension company and opted for three pension schemes, adaptable to their various branches (Finance, 28 August 2003).

The Labour Minister strongly emphasised the disadvantages of multiple funds (Finance, 7 September 2003). As a result, the disagreement with established providers and opposition parties intensified during the ordinary legislative process. The conservative SDS and Nova Slovenija (NSi) proposed to institute more than one fund and to let employees choose between supplementary pensions and the salary increase. Both amendments were rejected, thereby confirming the government's respect for the agreement with social partners. As partial reparation, the Act on collective supplementary pension insurance for public employees (Uradni list RS, 126/03) includes the possibility to establish new funds after three years of operations, in order to allow for different investment strategies.[27]

Once the legislative phase was over, the call for offers started in November 2003 (Uradni list RS, 111-112/03). The most important aspect of the process was the composition of the selection committee. Prospective providers were evaluated by a bilateral group, which comprised an equal number of representatives (six), experts (two) and one co-president each for the government and labour unions. According to union leader Branimir Štrukelj (interview), this committee represented the pinnacle of consociationalism in post-1991 Slovenia.

Before the selection process started, pension scheme providers led a media campaign against the chosen solution (one fund) and the selection criteria. The possibility that the 'public tender' was tailor-made for *Kapitalska družba* was half-heartedly hinted at even by KAD's new director, Borut Jamnik (Finance, 18 November 2003). Given the *dirigiste* aspirations of LDS, which aimed to have an institution capable of steering the Slovenian economy, an attempt to blend capitalism with Yugoslav real socialism was not out of the question (Finance, 26 September 2003).

Five supplementary pension providers presented their offers in December 2003 and three (KAD, Prva pokojninska družba and Moja naložba) were shortlisted. They started exerting strong pressure on both sides of the committee to retrieve insider information, especially on fees. Ultimately, KAD was picked for having outperformed competitors on all benchmarks.

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[27] The option has not been exerted. Finance Minister Andrej Bajuk, the successor of Mramor, only once mentioned the issue.

Various experts labelled the deal as political, and the other two competitors disputed the decision by claiming that their offers were better (Finance, 20 January 2004, 22 January 2004). Moja naložba even required a compliance audit and threatened to appeal to the Constitutional Court. The main argument was that the selection process should have been carried out as public tender, not through a bilateral arrangement. The auditing commission rejected these allegations. It substantiated that a bilateral pact between trade unions and the government is legitimate and that the premia involved are not public funds, but private revenues (Kalčič, interview). The collective agreement on supplementary pension insurance for public employees was then signed and KAD officially included into it (Uradni list RS, 11/04). Since these collective agreements are not contestable, all protests were truncated from the beginning.

After ascertaining that public employees were many more than initially thought, the premia started flowing in April 2004. At the end of 2007, the scheme counted 180 thousand members and roughly EUR 250 million in assets. KAD therefore became the second largest insurance company on the Slovenian market.

Reform outcomes

Taking a step back, the system established with the 1999 reform became operative on 1 January 2000, following a shorter run for pensions triggered by massive purchases of insurance years. The policy outcome was far from what the 'White Paper' had envisaged. It comprised the following parametric measures:

- Gradual increase of the conditions for acquiring a right to old-age pensions for women (age 58/61 with 38/20 years of qualifying period or age 63 with 15 years of insurance period). By 2022 the reform is phased in.
- Bonuses and maluses. Permanent decrement for early retirement if the full qualifying period is not met (35/40 years for women/men). Higher accrual rates for working longer.
- Widening of the calculation period from ten to 18 best consecutive average net wages.
- Change in the PAYG benefit formula: 38% and 35% of the assessment base for women and men for first 15 years of contributions and 1.5% for every subsequent year.
- Introduction of a state pension to all persons above 65, who lived in Slovenia for 30 years and who do not qualify for a first pillar pension. The benefit is equal to one third of the minimum assessment base.
- Reform (delayed by three years) of disability pensions and new cash benefits (partial disability, occupational rehabilitation etc).

Table V.10 presents a schematic summary of the new pension system.

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Table V.10 Multipillar system in Slovenia

Pillar	Zero (non-contributory)			First (mandated, earnings-based)			Second (mandated, earnings-based)			Third (voluntary)		
Provision Financing Objective	Public	Tax-financed Means-tested Basic Benefit	Poverty alleviation	Public	PAYG Non-financial Defined Benefit	Insurance	NA[1]	NA[1]	NA[1]	Private	Financial Defined Contribution	Insurance

	Benefit	Coverage	Eligibility	Benefit level	Indexation	Beneficiaries	Expenditures %GDP
Basic pension - Zero pillar	State pension	Persons above 65	Person not qualifying for first pillar pension	One third of minimum pension assessment base	Growth of minimum pension assessment base	NA	NA

	Vesting period	Contribution rate	Contribution floor and ceiling	Benefit rate	Assessment base	Retirement age	Indexation
Old-age pensions – First pillar	15 years minimum 20 years statutory	TCR: 24.35% 15.5% employee 8.85% employer	Minimum base set nominally at around 60-64% of national net wage. Maximum is four times the minimum.	35/38% of assessment base for men/women 1.5% for every contributory year above 15	Best 18-year average of net wages in 2008	63 for men in 2009 and 61 for women in 2023	Net wages

	Vesting period	Retirement age	Tax treatment (contributions, returns, benefits)	Contributions tax deductible for employers	Lump sum payments possible
Supplementary pensions – Third pillar	10 years	50	Exempt Exempt Taxed Contributions up to 24% of first pillar contributions are exempt	Yes	Yes

Source: Holzmann and Guven (2008). TCR – Total Contribution Rate. [1] Slovenia has a mandatory FDC pillar for all public employees (25% of labour force) since 2004.

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Distributional consequences

Due to insufficient resolve, Slovenian policymakers only partially retrenched the public PAYG system. The cuts are substantial, but, as Proposition 3 suggests, there is a trade-off between the system's generosity and its fiscal stability in time. The equity dimension, reinforced through numerous safeguards, was prioritised at the expense of the long-term financial viability of ZPIZ. Whereas public pension benefits are still roughly adequate, a number of pressing issues stand out: i) valorisation and other rules are complicated and cause the system to be intransparent; ii) there are few incentives to delay retirement; iii) despite generous tax incentives, neither voluntary private schemes nor the mandatory supplementary pillar for public employees are as successful as planned, and they reflect an increasingly two-tiered labour market. The system needs further rationalisation, not only to render it intelligible to the public, but also (and more importantly) to increase its fiscal sustainability in the future.

Public pillar adequacy

Holzmann and Guven (2008: 221-224) calculate that Slovenian pensions, despite the parametric cuts, are still some of the most generous in the region. Neither workers with full nor those with partial careers are at high risk of poverty. Hence, the rise in fixed-term employment (18.5% of total employees in 2007) should not represent an insurmountable problem. In general, single women have the worst income prospects upon retirement (Stanovnik and Kump, 2008). In consequence, a 2003 amendment widened the range of social contributions paid by the budget for particularly vulnerable categories, such as childrearing parents and homecare assistants, while the residence-based state pension remained a safeguard of last resort against absolute destitution.

What is more pressing is the opacity of the existing system. For example, in 2008 the valorisation coefficients applied to wages was only 75% of actual nominal wage growth over an 18-year period. The calculation of the insurance period is intricate. Hence, experts such as Stanovnik (2007: 4-8) advocate the introduction of a point system, as officially proposed until 1998, to simplify (and fiscally balance) the overly complicated Slovenian pensions.

A greater correspondence between benefits and contributions would also strengthen the incentives to delay retirement. These are, according to Ahčan and Polanec (2008), currently missing. The two authors also contend that low wages, relative to generous pension benefits, as well as widespread early retirement policies, combine to provide disincentives for low-income, less educated employees to work longer. This results in very low employment rates for older workers, i.e. just 33.5% for those aged +55-64 in 2007. Not surprisingly, Slovenia does not have a clear plan for active labour market policies that may address the problem (Redek, Domadenik, and Ograjenšek, 2008: 75-76).

Private pillar adequacy

Despite the swift evolution and consolidation of the supplementary pension market, there are still many unresolved issues. Among these, regulatory problems are worth mentioning: the imperfect institutional structure of supplementary pension schemes, excessive guarantees and crowding out effects hamper healthy competition among funds (Žnidaršič Kranjc, interview). In addition, premia are too paltry to make up for lower public pillar benefits and coverage is patchy, as only employees in large enterprises and in the public sector are collectively insured (for an overview, see Berk, 2009; Berk and Skok, 2005).

The regulatory oddities of Slovenian voluntary pensions are the result of indulgence towards the financial service industry. Different providers are allowed to offer private pension plans: mutual pension funds, pension companies, insurance companies, KAD. These entities are subject to different laws (the Pension and Disability Insurance Act, the Insurance Companies Act), they are supervised and licensed by different agencies (Securities Market Agency, Insurance Supervision Agency, Bank of Slovenia), they have a different legal status (a mutual pension fund is not a legal entity, a pension company is), they evaluate assets differently (market value for mutual pension funds, historical cost for insurance companies). As a consequence, neither their products nor their status are comparable, skewing competition and disrupting the level playing field (Vouk, interview).

Such inadequate legislation created institutional advantages for pension companies, which, excluding KAD, swiftly conquered the market (Finance, 9 March 2001). Their managers abuse the rules and tunnel out cheap financing, pay out dividends due to expectations of high capital returns, shield each other through cross-shareholding and avoid the *de facto* dual supervision reserved for mutual pension funds. Performance- or fee-based competition was disrupted from the very beginning. Pogačar (interview) claims that criteria other than cost or returns, i.e. being a shareholder or already having a life insurance or deposit, played a greater role in the affiliation of employers to individual providers of collective schemes.

In addition to inadequate regulation, Slovenian supplementary schemes have two main safeguards, a minimum guaranteed return and rather rigid quantitative investment restrictions, which encourage herding behaviour and short-termism. The excessively favourable tax treatment of public employee premia flowing into the *Kapitalska družba* crowds out other funds (Finance, 3 May 2004). Finance Minister Mramor's well-intentioned move created an ill-defined pension provider entity (it is still unclear what legislation KAD follows), which controls by fiat 40% of the market. The development of modern, competitive supplementary pension schemes in Slovenia still requires uniform standards and harmonised legislation.

Some improvements were introduced in 2001 (Uradni list RS, 109/01), when tax exemptions were clarified, collective schemes were separated from individual ones and rendered less onerous to set up. Now instead of two thirds, only half of an employer's workforce needs to join. This resolved the problem of older and seasonal workers. Employees who own a quarter of the capital or have 25% of voting rights in an enterprise cannot be collectively insured to avoid the double fruition of tax exemptions, frustrating the creation of collective schemes in small and medium enterprises (Finance, 16 May 2002). The adoption of the Directive on the Institutions for Occupational Retirement Provision in 2006 will possibly bring further improvements.

Apart from regulatory problems, the private pension business in Slovenia shows persisting triviality (for a detailed discussion, see Majcen and Verbič, 2009). Altogether, the 12 providers collected EUR 1.05 billion by December 2007. Coverage is patchy and insufficient, as only 50% of the active population in insured, mainly through collective plans. Monthly premia are paltry and amounted in 2007 to less than EUR 33 for public employees insured with *Kapitalska družba* and EUR 46 per month for those in occupational schemes. That is equivalent to circa 3.6% of the average gross salary. Most alarming is that even these sums are too high for labour-intensive industries, whose employees are not registered in the third pillar. Compounded with relatively high minimum pensions, the obstacles to the development of voluntary pensions seem hardly surmountable (Štrovs, interview).

Fiscal viability

The impossibility by Slovenian decision-makers to marshal enough strength to structurally reform the pension system resulted in the procrastination of cost saving measures. The inability to impose even slight changes in indexation rules after the 1999 reform, mainly due to the continuous participation of DeSUS in government, left Slovenian public pensions in a fiscally unsustainable situation.

ZPIZ has been running deficits since 1996, when the government decreased the contribution rate for employers, and has never recovered since. Verbič, Majcen and van Nieuwkoop (2006: 75-76) estimate that the Institute's deficits will reach 8-12% of GDP by 2040. Of the same avis is the European Commission (EPC, 2007: 314-315), which forecasts ZPIZ's deficits running almost up to 9% of GDP by 2050. The IMF (2006: 41) calculates that the intertemporal fiscal gap (the necessary current annual structural adjustment in the public balance) will reach 10.2% of GDP.

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Parametric changes may represent a temporary solution to the crisis. If only benefits are cut, then reductions will threaten the consumption smoothing of all but high-earning full career workers. If only the retirement age is to be adjusted, then it will have to rise well above 70 (Holzmann and Guven, 2008: 224-228). So reforms will have to be a combination of lower indexation and a simultaneous increase in the retirement age. During 2007, SDS made a feeble attempt at doing just that. The Labour Minister Marjeta Cotman proposed to shorten the transition period for the introduction of higher pensionable age for women by six years, from 2023 to 2017, and to introduce decrements in 2008 instead of in 2017 (Delo, 1 June 2007). ZSSS's immovable stance caused the government to withdraw even this unimpressive proposal.

Ultimately, deeper changes to the current pension system are necessary. The introduction of a point system would create a stronger contribution-benefit link. Moreover, the fiscal rebalancing of the Slovenian pension system requires a concerted effort in many labour market and social policy areas.

Political sustainability

Proposition 4 argues that reforms shall be considered as a process and not as an event, so require continuing political support at all levels. This can be reasonably secured through inclusive policymaking, which results in a broad agreement that rewrites the underlying social contract. Both the Slovenian parametric pension reform and the extension of supplementary pensions to public employees in 2003 proved to be politically stable. Whereas the latter was a proper bilateral deal, the wide acceptance of the former is subtler. After the rejection of most systemic elements and despite the narrow support in the National Assembly, the path-dependent character of the 1999 reform pleased coalition partners and opposition alike. Apart from the Democratic Party of Pensioners challenging one obfuscation element, the reform remained undisputed. The main problem is the inclusion of DeSUS in all government coalitions since the November 2000 elections. This has rendered further restructuring hardly possible. Only Janša's Slovenian Democratic Party, during its crusade against labour, reformed the management of ZPIZ but failed to introduce any systemic ameliorations, bequeathing a problematic legacy to the following government.

The sole challenge to the 1999 reform stemmed from Art.151 of the 1999 Pensions Act that introduced the calculation of two different indexation rates: one for new pensioners and one for existing ones. The latter is always lower than the former due to an element of transgenerational equity, which reduces the yearly adjustments of the stock of pensions in function of the eligibility and accrual criteria of new pensioners (Kidrič, 2002: 4, 6; Kokot, interview). The pensioner party DeSUS was baffled at discovering that current pensioners were

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losing purchasing power and brought the issue to the Constitutional Court, which upheld the norm in 2003. The Court argued that the rule does not discriminate current beneficiaries and that it decreases the financial burden borne by the active generation (Uradni list RS, 133/03).

DeSUS resented Finance Minister Rop's decision to curtail the growth of pension benefits in December 2000. Although the Economic and Social Council endorsed the cut, DeSUS considered it a historic tort (Delo, 30 August 2005). In mid-2004, under Premier Rop, both DeSUS and SLS demanded and failed to obtain more favourable indexation rules as compensation (Finance, 30 July 2004). This also represented a justification for the populist parties to support the following conservative government.

Since the October 2004 election did not produce a clear majority, the post-electoral horse-trading saw DeSUS manage to secure a number of concessions from its former enemy, Janez Janša's SDS. Central to the agreement were generous indexation and survivor pensions (Finance, 22 November 2004). These populist measures and the confrontation with trade unions is all that is left of Janša's retirement policy.

After 26 years at the head of ZPIZ, the conservative government vetoed Janez Prijatelj's reappointment and nominated Marijan Papež (Finance, 14 January 2005). Despite the warnings by the EU, the IMF and Slovenian economists, Labour Minister Janez Drobnič tabled a number of populist amendments and declared that their discussion within the Economic and Social Council is pointless (Finance, 30 May 2005). In addition to increased indexation, SDS decided to radically change the composition of ZPIZ's executive board and assembly. The initial plan envisaged the institution of a single council comprising 21 members, 11 appointed by the executive. The social partners fiercely opposed the proposal and argued that amendments to the 1999 Pensions Act specifically require tripartite negotiations (Delo, 18 April 2005).

Drobnič retreated on the most radical points and the amendment was legislated in July 2005 (Uradni list RS, 72/05). It brought indexation very close to net wage growth (including retroactive payments), significantly increased a yearly 'recreation' grant and lowered eligibility requirements for survivors, further worsening the system's long-term fiscal balance. In addition, it eliminated the Institute's executive board and assembly and strengthened the government's role in its management. The newly established council has 27 members, of which ten are nominated by the government, six by the unions, four by employers, five by pensioner associations, one is a representative of the disabled and one of ZPIZ employees.

As mentioned above, attempts by the following Labour Minister Marjeta Cotman to fix these flaws failed. Hence, Janša's legacy is negative: the financial position of ZPIZ deteriorated as a result of higher indexation, social dialogue became more conflictual and KAD's status was left unchanged. Instead of divesting its vast properties, the state strengthened its grip over the

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Slovenian economy and forced the best cadres to abandon the executive. Regrettably, Borut Pahor's centre-left coalition, elected in September 2008, again struck an alliance with DeSUS. Protracted policy paralysis in the area of pensions is thus foreseeable.

Conclusions

The Slovenian 1997-1999 and 2002-2003 paradigmatic reform attempts (the restructuring of public pensions system and the creation of a funded pillar for public employees) illustrate the perils of divisive policymaking in an environment characterised by extensive checks and balances, and the difficulty in reaching compromise between distant policy positions.

In both instances, the unilateral imposition of reforms failed. Later, more skilful employment of Natali-Rhodes trade-offs led to consensual agreements with those actors that vetoed reforms. Although more inclusive policymaking and a less confrontational stance on the policymakers' side guaranteed the future political sustainability of reforms, this happened at the expense of policy integrity. The original proposals were severely diluted. In particular, the restructuring of public retirement did not sufficiently address the fiscal aspects of the problem, rendering a renewed reform effort necessary.

The reform of the retirement system was problematic for two reasons. First, Slovenia was the only country in Central, Eastern and Southeastern Europe, where neither the normative legitimacy of the pension system nor its expected performance led to a self-undermining process of popular aversion. Second, the political arena and the country's corporatist tradition worked against a structural overhaul. Policymakers' choices are still constrained by a political-institutional structure that gives disproportionate power to the labour movement, embodied in the successor union Association of Free Trade Unions in Slovenia, and the inclusion into almost all coalition governments of the single-issue Democratic Party of Pensioners.

Initially, the pension system crisis had a marked fiscal component, due to excessively generous retirement conditions. Following a run on pensions during 1990-1992, the ratio between beneficiaries and the insured deteriorated and spending skyrocketed. Proposition 1 contends that once the possibility to resort to refinancing and retrenchment dries up, restructuring enters the agenda. The inadequacy of early responses, especially of the 1992 reform attempt, opened the floor for more serious debate on the future of Slovenian retirement. Given the strength of civil society and of the social democratic current, a negotiated bargain was the only available option.

The 1997-1999 reform was a genuine attempt by Labour Minister Anton Rop to structurally overhaul the retirement system and introduce a multipillar scheme. Rop was appointed after United League of Social Democrats quit the LDS-led government coalition,

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ending years of stalemate in social policy. The policymaker invested his political career in the reform and drafted the slightly amateurish 'White Paper on the Reform of the Pension and Disability Insurance in Slovenia'.

As suggested in Proposition 2, Labour Minister Rop tried to exploit the credit claiming potential of the reform's structural features, and use Natali and Rhodes' trade-offs to achieve a number of policy objectives. Slovenian old-age and disability insurance worked even too well. Yet increasing the country's competitiveness required lower social contribution (drastically reduced in 1996) and hence a more efficient and less generous pension system. So the 'White Paper' envisaged the possibility of transforming the public pillar into a point system, strengthening the contribution-benefit link, as well as introducing mandatory and extended voluntary funded private schemes.

Given that the public was, at least initially, in favour of lower redistribution and partial privatisation, what accounted for the rejection of most systemic innovations, including partial privatisation, so eagerly supported by the World Bank? First, the tension between financial viability and the introduction of funded elements partly explains the negative stance of successor union ZSSS and coalition partner DeSUS. Both feared that advance funding was the first step towards the demise of public pensions. Second, Rop made a fundamental mistake for a decision-maker operating in a consensual democracy. He excluded the Association of Free Trade Unions from negotiations, despite pretending that a new social contract would be built upon the 'White Paper'. As a result, the proposal wrecked against the opposition of ZSSS, which staged the greatest demonstration in Slovenian history to protest against funding. Labour Minister Rop sacrificed most policy objectives to save his political career and LDS's electoral potential. A gradual, parametric reform rendered benefits less generous and stabilised expenditures in the medium term.

Nonetheless, privatisation was not outright abandoned. The plan to create a mandatory funded pillar for public employees materialised. It followed a similar path as the main reform. The attempt initially failed, again due to Anton Rop's confrontational stance. By contrast, Finance Minister Dušan Mramor understood the importance of social dialogue to achieve multiple socioeconomic goals. By many described as the pinnacle of Slovenian consociationalism, the complex bilateral agreement extended private pension insurance to all public employees. In line with Proposition 2, policy innovations were very sensibly traded for the unions' demands for office (co-management in the scheme's selection) and particular technical solutions. The deal spurred Slovenian domestic savings and contributed to the de-indexation of the economy, a fundamental step towards Euro adoption.

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Minister Mramor's achievement casts doubts that the timely inclusion of the Association of Free Trade Unions in Slovenia in the drafting of the 'White paper' would not have yielded a different result. With hindsight, it becomes questionable whether to share Stanovnik's (2002: 65) scepticism: he contends that the social partners' negative attitude might have jeopardised the whole policymaking process from the beginning. This is a possibility every policymaker should take into consideration. Given successful future compromises, Labour Minister Anton Rop should have taken the risk and faced the unyielding corporatist actor.

As predicted in Proposition 4, the inclusive character of policymaking put in place enough incentives to ensure continuing political support in the future. Similarly to the Polish case, the recreation of favourable reform conditions proved impossible. Relative policy paralysis marked the whole post-reform period, even after Janez Janša's conservative executive took power. In particular, the participation of DeSUS in most coalition governments prevented the lowering of benefit indexation below net wage growth.

Protracted immobility exposed the shortcomings of existing retirement arrangements. At first, the ILO praised the 1999 reform for cutting a quarter of future benefits (Fultz and Ruck, 2001: 40). However, recent estimates show that Slovenia does not fare well with respect to Proposition 3. This signals the fundamental trade-off between the fiscal viability of a pension system and its social adequacy. The Slovenian public pillar has been running deficits since 1996, when the government significantly slashed employer contributions. The Institute for Pension and Invalidity Insurance is projected to become fiscally unsustainable from 2020 onwards. In addition, intransparent valorisation and other distortions make calculations complex and redistribution obscure.

No government after 2000 has addressed the problems above and therefore Slovenian retirement still needs to be reformed. In order to face future demographic challenges without disrupting the country's fiscal position, a mixture of parametric fine-tuning or, eventually, a systemic overhaul is required. The introduction of a point system would create a transparent contribution-benefit link (Stanovnik, 2007), but, it is hard to imagine that the Social Democrats, who formed in 2008 an alliance with the omnipresent DeSUS, will be determined enough to break with the past and structurally reform Slovenian old-age retirement.

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VI. Comparative conclusions

Introduction

After individually presenting two decades of pension reforms, this chapter compares Croatia, Hungary, Poland and Slovenia in order to retrace regularities between their institutional settings, actor constellations, policymaking strategies and reform outcomes. The evaluation enables us to systematically address the three research questions: Why was reform possible and how was it carried through? What are its distributive consequences? Does it guarantee long-term political support?

In order to study the political economy of pension reform legislation and implementation in the four Central, Eastern and Southeastern European countries, the dissertation employs a modified version of the Natali-Rhodes theoretical framework. The framework is designed for Bismarckian countries and the two authors make three broad claims. First, recent pension reforms are increasingly de-politicised, as the locus of negotiations shifts to the corporatist arena. Second, the skilful employment of political and policy trade-offs allows policymakers to craft complex negotiated bargains with the pro-welfare coalition. In particular, the two authors posit that the road is not so narrow. Reforms are multidimensional so that political as well as corporatist actors can exchange policy, office and vote. Finally, they show that benefit cuts can be traded not only with institutional power, but also with policy innovations, such as the introduction of funded elements, and various improvements in generational and functional equity.

Despite its potential for generalisability, the original framework has to be modified to fulfil two main aims. First, the dissertation extends the 'time horizon' of analysis and encompasses both the legislation of pension reforms as well as their implementation. This requires the explicit insertion of the Natali-Rhodes framework into the political-institutional context of the four cases, as the autonomy enjoyed by individual executives and their policymaking styles bear a fundamental influence on the reforms' distributional consequences and political sustainability. Second, despite broad similarities with conservative-corporatist regimes, the actor constellations in post-socialist countries (as well as their specific policy objectives) differ with respect to their Bismarckian counterparts. In particular, institutional legacies give disproportionate power to a number of elite welfare stakeholders (the state bureaucracy *in primis*) and popular perceptions of the past encourage the reinterpretation of certain policy objectives, e.g. equity is frequently recoded as greater individualisation as opposed to collectivisation of risk.

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The dissertation employs such a remodelled Natali-Rhodes framework to assess the appropriateness of the propositions presented in Chapter I, and that are enumerated hereafter.

Proposition 1 is related to the timing and reasons for the introduction of reforms.

> *As the possibilities to enact simple corrective measures (refinancing and retrenchment) to post-socialist retirement systems shrink to non-existence, policymakers engage in negotiated bargains, which increase their room for manoeuvre vis-à-vis the pro-welfare coalition. Complex political exchanges become central for the restructuring of these public schemes.*

The dissertation claims that deep crises progressively limit the room for benefit cuts, despised by the pro-welfare coalition, or increased contributions, which clash with economic competitiveness. Hence, policymakers are forced to bargain with the defendants of the status quo to restructure the ailing retirement schemes.

Proposition 2 closely echoes Natali and Rhodes' core argument on the feasibility of pension reforms.

> *Paradigmatic reforms that seek to introduce policy innovations, such as funded elements into a PAYG system, enjoy greater policy multidimensionality than parametric reforms. Hence, these negotiated bargains involve credit-claiming tactics as much as blame avoidance strategies. In particular, the new funded element's credit-claiming potential is often traded for substantial cuts in public pension schemes.*

Given a substantial convergence between the supply of policy innovations, mainly through transnational policy actors, and the demand for them, often backed by a 'negative consensus' against the old public schemes, policymakers see their room of manoeuvre increased vis-à-vis the pro-welfare coalition. Innovative policy solutions can be successfully exchanged for benefit cuts through the exploitation of different policy and political trade-offs.

Proposition 3 establishes a link between the policy dimensions traded during legislation and their subsequent distributional effects.

> *There are fundamental trade-offs between the fiscal and social dimensions of pension reforms. Excessive emphasis on financial viability and economic competitiveness may conflict with sound social policy. Conversely, the inability to eliminate unjustified special privileges and failure to tighten the contribution-benefit link in public schemes may result in a disproportionate burden for the fiscal budget, for the production regime's competitiveness or for both.*

A reform's success and acceptability increases if it strikes a fair balance between its fiscal stability and social adequacy. Otherwise, excessive emphasis on internal savings may trigger popular backlashes and financially unsustainable schemes are detrimental for a country's overall competitiveness.

Proposition 4 considers the impact of different policymaking styles on the political support for pension reforms.

Negotiated bargains are qualitatively very different one from another. Inclusive policymaking, as opposed to limited bargaining, may increase both the adaptability of reforms to changing socioeconomic circumstances and their political sustainability in time. Costly deviations from efficient solutions (e.g. the uneven distribution of gains and losses) are more easily avoided and incentives to stick to the reform's design are put in place.

The dissertation considers reforms to be a process and not an event, which requires continuous political support at all levels. Provided that there are no critical exogenous intervening factors, e.g. a harsh economic or political crises that may dissipate consensus, a sufficient condition to guarantee political sustainability is to achieve broad agreement via inclusive forms of policymaking, and to rewrite a pension system's underlying social contract.

The drawbacks of such an approach are obvious, and are summarised in Chapter I, Table I.1. First, encompassing bargaining is rare. Divisive as opposed to inclusive policymaking is very likely in political-institutional environments that breed unconstrained executives. The existence of significant disproportionalities encourages the uneven distribution of gains and losses, and lowers the resilience of reforms to changes in political power. Second, negotiated bargains are easier said than done. Even when the political-institutional configuration generates enough checks and balances to encourage inclusive policymaking, lest the excluded actors mobilise at a later stage to reverse reforms, negotiations are at permanent risk of breakdown and may result in significant dilution.

In order to summarise the findings for the four cases and evaluate the applicability of the propositions above, the chapter is divided into three sections.

The first part compares the impact of socialism and of multiple transitions on political-institutional structures (the institutions of government, electoral competition and interest groups) as well as on the pension crises and early responses. The section assesses the degree of autonomy of the executives involved in pension reforms and provides an overview of the key constituencies idiosyncratic to each case. Finally, the pension crises and early attempts at reforms are summarised to show that a common set of problems, again displaying some characteristic traits, befell the four transition economies. In line with Proposition 1, these problems exhausted simple corrective measures available to policymakers, and to a varying degree put more fundamental restructuring onto the agenda, which in turn required complex negotiated bargains to succeed.

This broad introduction opens the floor to the second section, which discusses the policymaking and implications of successful paradigmatic reforms and major failures. The section addresses the applicability of Proposition 2 to the four cases. The overview of proposals, which display a high degree of similarity, and of the final and very dissimilar outcomes, is

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employed to ascertain how and whether the policy and political exchanges lying at the core of Natali and Rhodes' theoretical framework were instrumental to successfully arrive at reform agreements. The chapter analyses the relative influence of the supply of foreign policy solutions and domestic demand for intellectual innovations on agenda setting. In addition, the qualitative features of policymaking and the trade-offs determining the nitty-gritty of negotiations are summarised.

The last part of the chapter presents an evaluation of pension reform implementation in the four post-socialist countries. In order to test the validity of Propositions 3 and 4, the links between the policymaking style and compromises with implementation deficiencies and successes are unveiled. The section addresses both the trade-off between sound social policy and the systems' financial viability, and the implications that divisive versus inclusive policymaking have on continuing political support for the newly legislated pension arrangements. The main finding is rather dispiriting, as none of the systems seems to satisfactorily fulfil the three necessary conditions to be stable and unchallenged over time. Reforms are fiscally, socially or politically unsustainable. This implies that in all cases minor, and more often than not fundamental, corrections are needed.

Multiple impacts of transition

Existing studies on the political-economy of pension reforms in Central, Eastern and Southeastern Europe have so far paid only cursory attention to the broader context within which policymaking is embedded. In line with the basic tenets of historical institutionalism (Weir and Skocpol, 1985), socialist legacies and the extrication paths of former elites have multiple impacts on the institutions of government, the electoral and party systems as well as the strength of interest groups. Although all four cases qualified as national-accommodative socialist regimes (Kitschelt et al., 1999: 24), the section shows how they developed dissimilar political-institutional structures.

The most important factor considered by the theoretical framework is the degree of autonomy enjoyed by individual executives. It is argued that only specific political-institutional configurations render unilateral or divisive policymaking more likely than encompassing, inclusive bargaining. Decision-makers' conduct qualitatively differentiates the negotiated bargains that underpin systemic pension reforms.

Additionally, great emphasis is placed on the role of retirement systems in the transformational recessions and recovery. The severity of the post-1989 crises is a key factor to make sense of the early attempts at reform, to individuate the demand for policy innovation and to understand how and why fundamental restructuring enters the agenda in the individual cases.

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Political-institutional structures

During early transition, the four countries amended their constitutions and changed their electoral systems, radically modifying the institutions of government. After that, Hungary and Slovenia maintained their political-institutional configuration basically unaltered. In contrast, Croatia and Poland became parliamentary democracies with a clear division of constitutional powers and functioning electoral systems only later.

As it transpires from the country chapters, the political-institutional configuration displays great variation among the four cases and is the key to determining the degree of authority concentration in their executives. In order to correctly assess the constraints that an executive faces, Bonoli (2001) argues that (at a minimum) the institutions of government, electoral results and the strength of the pro-welfare coalition need to be considered. To achieve a reasonable degree of comparability, this chapter employs a stylised version of Lijphart's (1999: 2-4) composite index of democracy, which measures regimes on a majoritarian-consensual scale (less versus more constraints).

The index clusters around two dimensions: executives-parties and federal-unitary. The first one is pertinent for this study, and comprises five variables: i) concentration of executive power in single-party majority cabinets versus executive power-sharing in multiparty coalitions; ii) executive-legislative relationships in which the executive is dominant versus balanced ones; iii) two- versus multi-party systems; iv) majoritarian electoral systems versus proportional representation; v) pluralist versus corporatist interest representation.

These satisfactorily combine the political-institutional characteristics relevant to pension reforms. The first variable measures the power of the executive dependent on electoral results. The last variable, with a slight modification, assesses the strength of the pro-welfare coalition. The importance of the labour movement and social dialogue is here used as proxy.

Table VI.1 reviews the five variables for the four countries, and Table VI.2 ranks them on their majoritarian-consensual continuum. A legend gives explanatory details. The final result compares the grade of autonomy of the respective governments.

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Table VI.1 Political-institutional comparison

	Croatia	Hungary	Poland	Slovenia
i	HDZ single-party rule 1990-2000 - SDP-HSLS šestorka coalition 2000-2003 (minority government after 2002) - HDZ-centred coalitions under PM Sanader after 2004 (minority government until 2008)	MDF-KDNP- Smallholders coalition 1990-1994 - oversized MSzP-SzDSz coalition 1994-1998 - Fidesz-Smallholders-MDF coalition 1998-2002 - MSzP-SzDSz coalition after 2002 (minority government since 2008)	fragmented Solidarność-based coalitions 1990-1993 - SLD-PSL coalition 1993-1997 - AWS-UW coalition 1997-2001 (minority government after 2000) - SLD-PSL-UP coalition 2001-2005 - PiS-LPR-Samoobrona coalition 2005-2007 (minority government until 2006) - PO-PSL coalition after 2007	fragmented Demos six-party coalition 1990-1992 - cross-parliamentary LDS-centred coalitions 1992-2004 (centre-right coalition interlude in 2000) - SDS-NSi-SLS-DeSUS coalition 2004-2008 - SD-Zares-LDS-DeSUS coalition after 2008
ii	'very-presidential' system (death of President Franjo Tuđman) until 1999 - parliamentarism after 2000 Constitution	parliamentarism with strong executive (hegemonic aspirations under PM Viktor Orbán)	strong semi-presidentialism (hegemonic aspirations under Lech Wałęsa) until 1992 - weak semi-presidentialism after 1992 Small Constitution - parliamentarism after 1997 Constitution	parliamentarism with, at times, strong executive (decentralised nature of dominant LDS party and hegemonic aspirations under PM Janez Janša)
iii[1]	hegemonic party system until 2000 - moderate pluralism after 2000	moderate pluralism until 1998 - (quasi) two-party system after 1998	polarised pluralism until 1993 - moderate pluralism after 1993	moderate pluralism
iv[2]	mixed PR and FPTP system (rigging, gerrymandering) - PR system with threshold after 2000	mixed PR and FPTP system	PR system without threshold in 1991 - PR system with threshold after 1993	PR system with low threshold
v	fragmented unions and very weak leader (SSSH) - undeveloped tripartism - open conflict under President Franjo Tuđman - greater cohesion after 2000	fragmented unions, strong leader (MSzOSz) with strong ties to MSzP - semi-developed tripartism, paternalism through IRC - open conflict and abolition of IRC under PM Viktor Orbán	bi-polar unionism, strong antagonistic leaders (Solidarność and OPZZ) with strong party ties (AWS and SLD) - semi-developed tripartism, paternalism through Tripartite Commission - abandonment of political militancy after 1999-2001	fragmented unions and very strong leader (ZSSS) with weak ties to ZLSD - developed tripartism in ESC - open conflict under PM Janez Janša

[1]Dimensions developed by Sartori (1990). [2]The Polish and Slovenian electoral systems are regulated by their constitutions. In Poland it has to be PR, in Slovenia PR with 4% threshold.

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Table VI.2 Composite index of democracy

		Croatia		Hungary	Poland			Slovenia
		before 2000	after 2000		before 1993	1993-1997	after 1997	
i	Executive concentration versus power-sharing	++	-/--	++/+[1]	-/--	+	-/--	-/--
ii	Dominant versus balanced executive-legislative relations	++	--	-	++	+	--	-/--
iii[2]	Two-party versus multi-party system	++	-	+/-	--	-	-	-
iv	Majoritarianism versus proportional representation	+	-	+	--	-	-	--
v	Weak versus strong corporatist interest representation	+	+	-	-	-	-	--
	Majoritarian versus consensual type of democracy	++	-	+	--	-	-	--

[1]Oversized MSzP-SzDSz coalition counted as VH. [2]Excluding founding elections.

Legend

	i	**Ii**	**iii**	**iv**	**v**
++	Single-party majority	Presidentialism	Predominant/hegemonic party system	FPTP	Inexistent unions and no tripartism
+	Two/three-party coalition	Semi-presidentialism	Two-party system	Mixed FPTP and PR	Fragmented unions, weak leaders, undeveloped tripartism
-	Multi-party coalition	Parliamentarism with strong executive (e.g. chancellorship)	Moderate pluralism	PR high/multiple thresholds ≥5%	Fragmented unions, strong leaders, semi-developed tripartism
--	Minority government	Parliamentarism	Polarised pluralism	PR low threshold <5%	Coordinated unions, strong leaders, developed tripartism

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From the results, it emerges that during the major pension reform legislative phases, the four countries' executives enjoyed varying degrees of autonomy. The countries position themselves very differently on the majoritarian-consensual continuum. The Croatian government was the least constrained with respect to partisan or corporate actors, while Slovenia had to necessarily rely on negotiations to pass controversial legislation. Hungary and Poland occupied middle positions.

Croatia underwent a radical transformation in 2000. Before that, the country was a 'demokratura' combining excessively strong presidentialism with limited pluralism. Normalisation took place shortly after the death of President Tuđman and the demise of the Croatian Democratic Union. The Constitutional amendments shed presidentialism; the country embraced power sharing and gradually became a consolidated parliamentary democracy. The party system shifted from hegemonic to moderately pluralist, requiring coalitional governments. Social partners however remained weak.

Hungarian constitutional (the constructive vote of no confidence) and electoral rules (the mixed-member voting system) grant its governments substantial authority. A two-party system evolved from alternation between the centre-left and centre-right political coalitions that started with the ascendance of the Alliance of Young Democrats (Fidesz) to power in 1998. Successor union MSzOSz led the pro-welfare coalition, but weakened significantly under Fidesz.

Poland underwent a number of political-institutional alterations. The 1992 Small Constitution and the Presidency of Aleksander Kwaszniewski in 1995 eliminated the aspirations for strong presidentialism by Solidarność. Moreover, the 1997 Constitution introduced parliamentarism, firmly embedding Polish executives in a web of checks and balances. Finally, despite the existence of a workable proportional electoral system since 1993, unstable governing coalitions have nevertheless resulted. The over-politicised unions Solidarność and OPZZ shed their political aspirations at the turn of the century.

Slovenia displays the most coherent political-institutional configuration among the four. It is a neo-corporatist, consensual democracy, where party institutionalisation is low. Multiple institutional vetoes are compounded with a moderately pluralist and fragmented party system. The majority of post-1991 governments were grand coalitions and had to bow to the strong successor union ZSSS.

According to the framework, the constraints binding an executive fundamentally influence its policymaking style. Divisive strategies and limited bargaining are more likely in unconstrained environments, such as in Croatia and Hungary. Conversely, extensive checks and balances force constrained executives to resort to inclusive decision-making and encompassing negotiations, as in the case of Poland and Slovenia.

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In addition to those political-institutional features that influence an executive's autonomy, the dissertation adapts Natali and Rhodes' theoretical framework to the dissimilar actor constellations that operate in Central, Eastern and Southeastern Europe. In particular, the nature and quality of electoral competition subordinate the policy objectives of pension reforms to other aims and relegate negotiations of policy alternatives to the corporatist arena. Moreover, the pro-welfare coalitions differ with respect to their Western counterparts (see Cook, 2007: 18). The authority and role of social partners are more heterogeneous and other elite welfare stakeholders, such as the powerful state bureaucracy, have to be taken into account.

Orenstein's (2000: 61) claim that pension reforms cut across all historical and social divisions needs to be embedded in the broader issue of emerging programmatic competition. This study embraces the pessimistic view that this key feature of democratic consolidation failed to emerge in post-socialist countries. A clear economic cleavage did not freeze into a traditional Left-Right divide. Lack of programmatic, especially economic, alternatives prevented policy-based competition from surfacing. If it is natural that political coalitions represent conflicting interests, the lack of policy accountability implies that the problem runs deeper. Supposed social-liberal parties, such as the Social Democratic Party in Croatia or the Democratic Left Alliance in Poland, slashed redistributive measures and favoured flat tax rates, whereas self-professed champions of liberalism, e.g. the Alliance of Young Democrats in Hungary or the Slovenian Democratic Party, sunk into unabridged populism and nationalism.

This has major repercussions on pension reforms in the region. Policy choices are not only externally constrained by economic crises, as much of the literature stresses, but also frequently subordinated to vote- and office-seeking objectives. With respect to retirement policy, political competition is based either on technocratic (Poland) or populist (Croatia, Hungary, Slovenia) premises. In Poland this was due to the unfinished agenda, which both camps promised to finalise. In Hungary, the nature of electoral competition implied that ruinous compromises appeared after each political budget cycle. In Croatia and Slovenia, single-issue pensioner parties, which enjoy greater success than elsewhere in Europe (see Hanley, 2007), are a constant source of populism and are courted by centre-left and centre-right coalitions alike. Yet their presence interferes with the correct functioning of the two countries' retirement systems.

As for the actor constellations, both the strength of unionised labour and the composition of the pro-welfare coalition display considerable variation across the four cases. In addition to the social partners, the state-bureaucratic apparatus and the financial service industry play a significant role in the shaping and implementation of pension reforms. These elite welfare stakeholders have an overwhelming influence on policy, by virtue of their concentration, direct linkages to political power and interest in preserving their privileged statuses.

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According to Orenstein (2000: 62-66), the corporatist arena is still divided between 'old' and 'new' trade unions. The successors of official socialist-era unions inherited their assets, networks and resources. Given past affiliation, they are usually committed to the preservation of the status quo. With the exception of Solidarność, new unions are smaller, lacking resources and networks. Frequently they advocated pro-market reforms, such as pension privatisation. Although evocative, the image of the corporatist arena as a mirror of the political space is misleading. Where political affiliation was particularly strong, the labour movement simply stopped organising as soon as political allies came to power. Hence, rather than being a clash of titans, the antagonism between successor and new trade unions resembled a squabble among weaklings.

Despite its enfeebled state, organised labour played a prominent role in all cases but in Croatia. Here the unions were too disarrayed as ten years of HDZ hegemony all but effaced social dialogue. There are some signs of labour remobilisation: various confederations recently demonstrated together to ask for changes to the radical 1999 reform. In Hungary and Poland, the politicisation of the labour movement implied that fruitful exchanges between office and policy could be arranged. The bargains involved the trading of privileges for union leaders and overprotected working categories against somewhat diluted neoliberal reforms. Hence, tripartism was in both countries instrumental for the electoral aspirations of the overarching political parties. At the end of the 1990s, after years of abuses, the discredit was such that the Hungarian Interest Reconciliation Council was abolished and the Polish Tripartite Commission systematically boycotted. In contrast to the above, Slovenia qualifies as the only neocorporatist country in Central, Eastern and Southeastern Europe and has now a long tradition of social pacts. The strength of the successor union ZSSS (and public sector branches) implies that its consent was necessary to pass labour-related legislation. After an initial surge in popularity, the new unions in Slovenia markedly declined. Hence, the attempts to play the two camps against each other failed.

The other important players in post-socialist pension reforms were the vast state-bureaucratic apparatuses that ran these PAYG systems. Cook (2007) individuates in the social security administration, the welfare ministries and other bureaucracies those elite welfare stakeholders, which are highly connected and interested in the preservation of the status quo. Concentrating on state pension administrations, these attracted policymakers in two ways. First, the co-management functions of social partners and pensioner associations in these institutions were conducive to those office-versus-policy exchanges that are vital for pension reforms in Continental Europe. Second, the bureaucratic apparatus dealing with pensions is much vaster and includes important units, such as the tax administration (Fultz and Stanovnik, 2004: 30-31). This

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represents an important electoral constituency and can be filled with political appointees, starting with the leadership (see Orenstein, 2000: 67). Instead of making them redundant, these administrations had their functions strengthened, even in the face of promised ‘de-étatisation’.

In addition to using these institutions to claim credit, policymakers abused the state’s influence over its administration to divide and rule. The New Right, in particular, did not give up on its autocratic aspirations and the objective to break existing socialist oligarchies. In line with its elite replacement strategies, conservative parties systematically staffed national pension administrations with yes-men and reduced the unions’ managerial role. The cases show remarkably similar patterns. Under President Tuđman, the Croatian Democratic Union ousted weak organised labour from the Croatian Pension Insurance Institute, which also lost the management of its revenues to the tax administration. A similar fate awaited the Hungarian Pension Insurance Fund, as soon as Fidesz seized government. Under Solidarność, the Social Insurance Institution was filled with inept political appointees, possibly to deflect the blame for potential reform failures. Finally, Premier Janša’s Slovenian Democratic Party sacked the long-standing director of the Institute for Pension and Disability Insurance and radically downplayed the union’s influence in the institution.

As for the financial service industry, its functioning as interest group is split between the associations of private pension funds and their regulators. The former are chiefly interested in regulatory ameliorations, whereas the latter have a number of conflicting objectives, among which the funds’ performance is not always on top. It is important to note that before the setup of private pillars, powerful financial institutions were present only in Hungary and, to a limited extent, in Slovenia. In both cases, the inflicted damage was extensive in terms of corporate governance structures lobbied for and narrowly targeted advantages to specific players.

The most striking finding is related to the establishment of representative fund associations after the introduction of partial privatisation. All countries present significant failures with regards to self-regulation and performance. In most cases, the funds engage in anti-competitive practices, which range from herding behaviour to the establishment of cartels. Without entering into details, this dissertation shares the worries vented by Holzmann et al. (2008). The authors claim that returns have been uneven and disappointing, requiring a review of pension fund structures and accelerated financial market reforms to compensate the inevitable public pillar cutbacks.

Pension system crises and early reforms

Most of the literature attributes to pension system crises a fundamental role in convincing policymakers to reform ailing retirement schemes. Proposition 1 partially espouses this view and

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argues that once simple corrective measures, such as refinancing and retrenchment, are exhausted, decision-makers engage the pro-welfare coalition in complex negotiations to restructure old-age pensions. This means that under critical circumstances restructuring is paradoxically easier than straightforward parametric reforms, even though it requires an open confrontation with the pro-welfare coalition.

The effect of the transformational recessions on the region's pension system crises was significantly more uniform than the links between the politics of transition and retirement. There is no more than a casual connection between different developmental choices, e.g. gradualism versus shock therapy, and future pension reforms.

Table VI.3 illustrates that the countries' pension system crises shared many common traits. The growing number of pensioners (Row 4) resulted in sharp expenditure increases. Row 1 indicates that all of the countries but Hungary, which mainly resorted to inflationary savings, experienced spending hikes of at least 50% during the 1990s. Fewer and administratively more demanding contributors (Row 5), whose payments had to be now tracked individually and not mechanically collected from a handful of state-owned enterprises, implied that contributory revenues did not match expenditures any longer (Row 2).

The four transition economies tried to refinance the systems by raising contribution rates to unsustainable levels (Row 6) and simultaneously retrench current benefits through a number of formula adjustments, thereby lowering replacement rates – with the paradoxical exception of early transition Poland (Row 7). However, neither measure was sufficient. Social security deficits mounted and budget transfers to social insurance became increasingly burdensome (Row 3). Again Hungary was the exception, as it balanced lower revenues with decreasing benefits.

Orenstein (2000: 7) correctly suggests that putting all socialist systems into one basket is erroneous. However, Table VI.3 shows that three states, Croatia, Poland and Slovenia, were experiencing in the mid-1990s a retirement emergency, which had a marked fiscal component. The fourth, Hungary, developed such a complex mix between social insurance (contribution-financed) and social assistance elements (tax-financed) to be unintelligible in the eyes of the public.

Finally, the future fiscal outlook was disastrous in the whole region, mainly owing to very rapid ageing (for a detailed overview, see Holzmann and Guven, 2008: 12-17).

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Table VI.3 Pension crises compared

		Croatia	Hungary	Poland	Slovenia
1	**Pension expenditures/ GDP**	Collapsed in 1990-1992 to 7.7% of GDP, then almost doubled, by 2001.	Total spending peaked in 1994 and then stabilised around 9% of GDP.	More than doubled in 1989-1994, from 6.5% to 15.8% of GDP, declined after.	Increased from below 9% of GDP in 1989 to more than 14% after 1993.
2	**Pension revenues/ GDP**	Plunged in 1994-2001.	Constantly decreasing.	Constantly decreasing.	Matching outlays until 1996, stable but lower since.
3	**Pension balance/GDP**	Stable until 1994. Budget transfers increased to almost 6% by 2001.	Small deficits up to 0.5% of GDP.	Budget transfers increased from 2% in 1989 to more than 6% in 1992-1994.	Balanced until 1996. Budget transfers reached 4% of GDP in 1999.
4	**Number of pensioners**	Increased by 55%.	Increased by 21%.	Increased by almost 38%.	Increased by almost 26%.
5	**Number of insured**	Fell by almost 30%.	Fell by almost 25%.	Fell by almost 15%.	Fell by almost 10%.
6	**Contribution rate**	Rose until 1994 and declined since. Peaked at 27% of gross wages (pensions only).	Stable, at 37.5% of gross wages (total standardised contributions).	Stable, at 36.7% of gross wages (total standardised contributions).	Grew until the 1996 cut in employer contributions. Peaked at 31% of gross wages (pensions only).
7	**Replacement rate**	Fell from 75% to 45% of average wages, stable since 1995.	Declined by ¼ in real terms, stabilised at around 60% of average wages.	Rose from 56% to 72% of average wages and declined since 1996.	Declined from almost 90% and stabilised at 75% of average wages.

With the partial exception of Hungary, the stringent fiscal conditions eliminated further refinancing possibilities. Hence, all countries except Croatia (which was grappling with armed conflicts at home and abroad) introduced a reform package at the beginning of the 1990s to rationalise the system.

Instead of solving the pension system crises, these reform attempts exacerbated the problems above and in some cases rendered the systems even more indecipherable. The lack of a coherent plan was a common characteristic. The Hungarian 1991-1993 attempts were imbued with Premier József Antall's anti-capitalist ethos. Hungarian policymakers resurrected pre-war legislation and applied inadequate corporate governance structures to the Pension and Health Insurance Funds, as well as to the newly created voluntary pension schemes. The Polish 1989-1991 reforms had as its premise that older workers are the losers of transition, so their benefits should be increased instead of curtailed. The Slovenian rationalisation in 1992 was little more than window dressing and did not prevent the further deterioration of the system.

Consequently, a wave of austerity measures hit the agenda, embedded either in economy-wide austerity packages (Croatia and Hungary) or based on specific acts (Poland and Slovenia). The Valentić decrees in Croatia, the Bokros package in Hungary and several measures within the fiscal and cost trend in Poland (originating in the Balcerowicz Plan) were unilateral retrenchment attempts, which all partially failed. In Slovenia, the social-democratic party ZLSD quit the

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centre-left government coalition due to mild planned retrenchment. Years of social policy hijack ended as a result of innocuous eligibility restrictions.

Interventions such as the reduction of benefit indexation and more stringent eligibility criteria were one-dimensional, in that they only aimed to restore the fiscal viability of these schemes. Policymakers did not offer welfare state defendants a proper *quid pro quo* for reductions in acquired rights. These extraordinary measures lacked the legitimation of a social pact and the benefit of (transformational) crisis, which was at the time unambiguously over.

The similarity between the roles played by the Croatian, Hungarian and Polish constitutional courts in the rejection of austerity packages is striking for three reasons. First, the tribunals used identical arguments to declare the unconstitutionality of cutting accrued rights in a period not characterised by systemic crisis. Second, appeals to these tribunals were an option of last resort for civil society to oppose unwanted legislation at a time when other intermediation channels were closed. Finally, their intervention helped to push pension system restructuring onto the agenda.

In Poland, the Tribunal explicitly supported restructuring in contrast to *ad hoc* fine-tuning. In Croatia and Hungary, the courts mutilated both the Bokros package and Valentić decrees, signalling that governments better find systemic solutions to the crises. In Slovenia, the court did not intervene. However, the country firmly embarked on the way to restructuring when Anton Rop, a pro-reformist Labour Minister was instated, similarly to what happened in Poland with the appointment of Plenipotentiary Andrzej Bączkowski.

Restructuring

Even though pension system crises played a fundamental role in putting restructuring on the agenda in these four cases, the thesis finds that there are exceptions to the applicability of Proposition 1.

The theoretical framework assumes that three elements convince policymakers to consider fundamental restructuring: i) shrinking room for manoeuvre to enact simple corrective measures; ii) existence of a supply for policy innovations; iii) (popular) demand for systemic reforms. If the World Bank generously provided the technical and financial means to introduce systemic innovations, filling the scholarly vacuum inherited from half a century of socialism, restructuring seems to have sometimes happened in the absence of the two other conditions.

In Hungary, the crisis was not as severe as in the other cases and yet full privatisation entered the agenda through Finance Minister Lajos Bokros, a neoliberal thinker. In Slovenia, the pension system withstood the transformational recession, so a comparatively strong 'negative consensus' did not emerge against the public scheme, although 'Averting the Old Age Crisis'

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strongly inspired Labour Minister Anton Rop in his reform endeavour. This demonstrates that ideological beliefs, as well as government propaganda (e.g. Hungarian information campaign deliberately discredited public pensions), can compound systemic crises and influence the type of reforms opted for by policymakers.

The part of Proposition 1 that fully applies to all cases is that the seriousness of the crises required complex, multidimensional negotiated solutions. This appears to affect constrained and unconstrained environments alike. It is relatively independent of an individual country's intellectual mass and hence of the capacity to formulate alternative policy solutions. Complex political exchanges were needed not only in Hungary and Poland, where the official paradigmatic reforms represented just competing proposals that enjoyed greater prestige due to international financial and technical backing, but also in Croatia and Slovenia, where civil society did not produce any policy alternatives to the executive's plans.

So long as every pension system generates a number of vested interests in the preservation of the status quo, it also necessitates skilful exchanges between political and policy objectives to be reformed. In line with the framework developed by Natali and Rhodes, the success of restructuring is attributable to the ability of trading against each other different policy dimensions and appealing to the stakeholders' different objectives. By including the political-institutional features of policymaking into the two author's framework, and by extending its time horizon to implementation, the dissertation analyses three aspects of restructuring.

First, it employs the framework's policy and political trade-offs to individuate the *quid pro quos* that guaranteed the success of reforms (Proposition 2). Second, it argues that these trade-offs have a significant impact on the future distributional consequences of reforms (Proposition 3). Third, it claims that each negotiated bargain is qualitatively different from the other and that this influences both its immediate feasibility, as well as its political sustainability in time (Proposition 4).

In total, there were eight major restructuring attempts in the four cases between the mid-1990s and now.[28] As shown in Table VI.4, there are huge discrepancies between reform intention and outcome. Four out of eight attempts ended in non-agreements leading to severe output dilution or outright abandonment. Four reforms were successful, however, their future sustainability is not always guaranteed.

[28] Poland 1994-1996 and 1997-1998 may be counted as a single, longer reform endeavour.

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Table VI.4 Eight paradigmatic reform attempts

Observation	Coalition	Agenda-setter	Reform proposal	Reform outcome
Croatia 1998	Single party centre-right (HDZ)	Politicised Plenipotentiary	Structural: - point system in public pillar - mandatory and voluntary FDC pillars	Agreement, politically and socially unsustainable
Hungary 1997	Centre-left & liberal (MSzP-SzDSz)	Finance Minister Gyula Horn	Structural: - parametric reforms in public DB pillar - mandatory FDC pillar	Agreement, politically and, after severe dilution, fiscally unsustainable
Poland 1994-1996	Centre-left & agrarian (SLD-PSL)	Finance Minister Grzegorz Kołodko	Marek Mazur's proposal within the Strategy for Poland Structural: - parametric reforms in public DB pillar - mandatory FDC pillar	Non-agreement, abandonment
Poland 1997-1998	Centre-left & agrarian (SLD-PSL) Centre-right & liberal (AWS-UW)	De-politicised Plenipotentiary	Security through Diversity Structural: - NDC public pillar - mandatory and voluntary FDC pillars	Agreement, politically sustainable; perhaps socially unsustainable in the future
Poland 2003-2004	Centre-left & agrarian (SLD-PSL-UP)	Economic, Labour and Social Policy Minister Jerzy Hausner	Hausner Plan Parametric (conclude reforms started in 1997-1998): - complete rationalisation in public pillar - finalise regulation of funded pillars	Non-agreement, leading to severe dilution
Slovenia 1997-1999	Centre-left & agrarian & pensioners (LDS-SLS-DeSUS)	Minister for Labour, Family and Social Affairs Anton Rop	White Paper on the Reform of the Pension and Disability Insurance in Slovenia Structural: - point system/parametric reforms in public DB pillar - mandatory and voluntary FDC pillars	Non-agreement, leading to severe dilution; fiscally unsustainable
Slovenia 2002	Grand coalition (LDS-ZLDS-SLS-SKD-DeSUS)	Finance Minister Anton Rop	Structural: - restricted quasi-mandatory FDC pillar	Non-agreement, abandonment
Slovenia 2003		Finance Minister Dušan Mramor	Annex to collective agreement Structural: - expanded quasi-mandatory FDC pillar	Agreement, politically sustainable

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Proposition 2 lies at the core of every successful bargain. In fact, policy innovations widened the room for manoeuvre to policymakers, which managed to claim credit for systemic reforms and to exchange them for substantial benefit cuts. However, the details of negotiations differ widely. In order to account for the dissimilarities, Natali and Rhodes' analytical division between the policy and political aspects of bargaining proves to be very useful.

In particular, the dissertation individuates four fundamental bargains. Within the policy domain, effectiveness is traded for diverse aspects of intergenerational equity. Political deals include: compensation to particular social groups, office positions to social partners, and privileges to elite welfare stakeholders.

Policy trade-offs

Natali and Rhodes claim that the policy exchanges between policymakers and the pro-welfare coalition involves four reform dimensions: financial viability, economic competitiveness, equity and effectiveness. Financial viability and economic competitiveness are closely linked: the reduction in absolute terms of pension-related spending and contribution rates frees up important budget resources, reduces distortions in the labour and savings markets and boosts the competitiveness of domestic firms. Effectiveness longs for the minimisation of various types of leakages and greater performance with limited resources (as through funding). Finally, equity acquires in post-socialist countries a contrasting double meaning. First, it is traditionally invoked to expand risk collectivisation, in order to redistribute to the least protected strata. Second, it departs from the above by embodying the need for greater risk individualisation, as opposed to the uneven allocation of privilege.

According to Proposition 2, the main rationale for reforms that advocate the dual paradigmatic shift from collective to individual responsibility, and from public to private provision, is their manifest multidimensionality. In addition to those dimensions associated with parametric reforms (greater financial viability, lower contributory burden boosting international competitiveness), a tighter contribution-benefit link is an antidote to the unjust redistribution embodied in the retirement schemes inherited from socialism. More importantly, the introduction of funded elements increases competitiveness by promising higher savings, investments and hence economic growth. This also amplifies systemic efficiency, creating irrational expectations of high returns. Of course, a closer look at reform packages shows that such a free lunch is simply not possible and that someone has to pay for the transition costs and fiscal savings. The rhetoric employed in the policymakers' discourse is, however, sufficient to emphasise the credit, obfuscate future benefit reductions and so avoid blame.

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In addition to increasing the feasibility of reaching compromises, the four policy trade-offs largely determine the future balance between the fiscal viability and social adequacy of the new pension systems, stretching the reform's time horizon to implementation. Proposition 3, assumes that where systemic public pillar reforms are not offset by redistributive elements aimed at weaker societal segments, there may be a social emergency; yet where policymakers fail to rationalise public schemes, then their fiscal balance may be jeopardised.

Running the risk of oversimplifying matters, the dissertation shows that, in the policy domain, negotiations between policymakers and the pro-welfare coalition focus on various aspects of intergenerational equity. Greater effectiveness and risk individualisation were traded for explicit redistributive measures. This allowed for the exploitation of the generational cleavage, targeting different cohorts (three at least) with different policy objectives.

Already retired cohorts retain the status quo. They are excluded from reforms by maintaining their benefits intact (or via long-term, phased-in decrements through less favourable indexation) and by financing transition costs with taxes or debt, neither of which directly impacts on their current income. Furthermore, the risk for older workers is collectivised through temporary guarantees for a non-traumatic passage into retirement as all eligibility restrictions are being phased in gradually. Finally, younger cohorts are promised greater effectiveness and risk individualisation. The introduction of capital accumulation and the elimination of (communist-related) privileges obfuscate the reduction in first pillar benefits and the financing of current retirees via greater taxation, increased indebtedness or, in the best of cases, through earmarked privatisation revenues (cf. Brooks and James, 2001: 155-156, 159-160).

Paradoxically, this risk individualisation is partly neutralised by explicit safeguards, demanded by the pro-welfare coalition: maintenance of the PAYG pillar as key benefit provider, emphasis on explicit redistributive elements, and the introduction of private pillar guarantees.

In all four cases, the original reform designs invariably contain lower indexation, higher retirement ages and bigger funded pillars. Only in Slovenia a compromise on privatisation could not be reached. The social partners were convinced (perhaps correctly) that the funded pillar would lead to the depletion of public retirement benefits. The agreement failure led to the rejection of the private pillar and to severe reform dilution.

Even though intergenerational equity was the key to winning over the pro-welfare coalition, this required a number of additional, purely political exchanges.

Political trade-offs

Natali and Rhodes explain that policy is but one set of trade-offs underpinning fundamental pension reforms. This section illustrates the political exchanges between partisan

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actors, social partners (and, by analogy, elite welfare stakeholders) acting as vote-, office- and policy-seekers. Additionally, it extends the theoretical construction to political-institutional structures and modes of interaction that qualitatively differentiate one deal from the other.

As was amply shown in the country chapters, even technocratic policymakers had to subordinate policy aims to vote and office concerns. The dissertation individuates three recurrent exchanges between these objectives. The deals are driven by different logics:

i. compensation to particular social groups is granted to obtain the endorsement of partisan actors;
ii. office positions are promised to social partners to earn their acquiescence to radical policy solutions;
iii. privileges are allocated to elite welfare stakeholders to secure their vote or support for reforms.

Core political constituencies voice specific policy demands for protection, which are exchanged for continuing partisan support. These concessions enhance the privileges to particular social groups, resembling a prosaic version of what Natali and Rhodes call functional equity. In particular, agrarian parties demand the preservation of special schemes for farmers (e.g. the Polish People’s Party obtained the exemption of KRUS from reforms) or force onto the agenda minimum state pensions (the Slovenian People's Party to protect their rural electorate). Single-issue pensioner parties require the maintenance of the real value of pensions and other benefits for retirees. Most conservative parties and female Members of Parliament oppose the equalisation of retirement age.

Exchanging office for policy between decision-makers and social partners is a favoured bargain in Bismarckian systems. Social partners involved in state pension administration want to retain or expand their managerial tasks. They often require having a say in the supervision of the funded pillars. Office concessions to social partners in exchange for their vote is also possible, especially when union affiliation with political parties is close, as in Hungary and Poland. The political appointment of the leadership of successor union MSzOSz, which aimed to recuperate consensus among leftist voters of the Hungarian Socialist Party, is a case in point.

The targeting of elite welfare stakeholders is a direct exchange between policy privileges and their vote or continuing support for reforms. The importance of targeted benefits depends on the connections between the party system and particular constituencies. In all Central, Eastern and Southeastern European countries, the state-bureaucratic apparatus obtains the preservation and expansion of existing tasks. Where ruling elites heavily rely on certain interest groups (e.g. the Croatian Democratic Union on Homeland War veterans), these can be singled out and treated preferentially.

Although complex negotiated bargains show the importance of expanding the room for manoeuvre of policymakers, this cannot fully explain the differences in individual deals and their repercussions during implementation. Proposition 4 requires that pension reforms be seen as a process and not as an event – hence, as a series of repeated games. Accordingly, the double trade-off framework needs to be upgraded and take into consideration the political-institutional setting in which negotiations take place (majoritarian or consensual, which are used as proxies for the constraints faced by individual executives) as well as the decision-makers' attitudes vis-à-vis other political and corporatist actors (divisive or inclusive).

These two aspects determine a number of qualitative differences between pension reforms that are largely responsible for their immediate feasibility and their subsequent political sustainability. Table VI.5 places the eight reform attempts into distinct categories.

Table VI.5 Institutions, policymaking and outcomes

		Composite index of democracy	
		Majoritarian (unconstrained executive authority)	**Consensual (constrained executive authority)**
Policymaking style	**Divisive**	Croatia 1998 (UA) Hungary 1997 (UA)	Poland 1994-1996 (NA) Poland 2003-2004 (NA) Slovenia 1997-1998 (NA) Slovenia 2002 (NA)
	Inclusive	-	Poland 1997-1998 (SA) Slovenia 2003 (SA)

NA – Non-Agreement. SA – Sustainable Agreement. UA – Unsustainable Agreement.

The table above needs to be unpacked, as it shows two contrasting effects. On the one hand, it draws a sharp distinction between the circumstances that lead to agreements and those that do not. The cases confirm what veto actor theories have to say about environments riddled with checks and balances: divisive (unilateral) decision-making may lead to the mobilisation of excluded actors and generate stalemates, dilution or even abandonment of policy.

On the other hand, these negotiated bargains elicit diametrically opposed future reactions. Conceiving pension reform as a process that runs beyond legislation, its political success (sustainability) during implementation requires that the underlying social contract be rewritten. This means that reformers should adopt inclusive rather than divisive bargaining strategies and take into consideration the interests and expectations of the broader polity. Failing that, even though the legislative phase is successfully carried through, implementation may not be accompanied by sufficient incentives to ensure continuing political support at all levels.

A description of the four agreements and four non-agreements precedes the detailed discussion on the three types of policy sustainability, presented in the final section.

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Non-agreements

All four instances of negotiations leading to non-agreement happened in consensual institutional environments, i.e. in Poland (1994-1996 and 2003-2004) and Slovenia (1997 and 2003). These substantiate that unilateral policymaking is a very risky strategy for constrained executives, as the literature on welfare state reforms has abundantly shown, either employing veto actor theories, or not (Orenstein, 2000: 13-17; Bonoli, 2000: 146-149). In Poland, both reform attempts witnessed the appearance of institutional veto players (internal opposition by Labour and Social Policy Ministers), which led to protracted statements and consequent abandonment or dilution of policy. In Slovenia, two reforms failed, because excluded groups mobilised after policymakers bypassed confrontation (the successor union ZSSS in 1998 and public employees through the Constitutional Court in 2002).

Between 1994 and 1996 in Poland Finance Minister Kołodko proposed a radical privatisation plan, which was staunchly opposed by Labour Minister Leszek Miller. This led to a two-year stalemate, which ended only with the removal of Miller. The creation of the Polish Plenipotentiary was then an effective means to depoliticise the reform and minimise intergovernmental struggle. A similar impasse happened again seven years later. Jerzy Hausner, the Minister of the Economy, Labour and Social Policy, proposed to finalise the 1997-1998 structural reform, which had left many regulatory acts pending (bridging pensions, the annuities law, unreformed farmers' and disability pensions, non-equalised retirement age). The initial round of consultations tried to be as encompassing as possible; after all Hausner had been a very pragmatic Plenipotentiary. However, the break-up of his Ministry into two separate bureaus was a strategic mistake, adding unexpected opposition against the Hausner Plan, which got diluted to marginality.

Anton Rop's two attempts to introduce private elements into Slovenian pensions fared even worse. In 1997, the Labour Minister's team drafted the 'White Paper', a systemic reform proposal, without consulting the social partners and, among them, the powerful successor union ZSSS. In 2002, as Finance Minister, Rop unilaterally converted part of the salary increases of public administration employees into premia for supplementary private pensions, again without consulting the main state administration union. Both proved to be coarse mistakes for a consensual democracy that had an interrupted history of social pacts since 1994. In the first case, negotiations broke down and Rop withdrew the most progressive elements of the reform package (the point system and the mandatory funded pillar). In the second case, the Finance Minister *de facto* transformed voluntary into mandatory pension insurance by decree. The measure was procedurally and substantively illegitimate, and therefore declared unconstitutional in less than three months.

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Agreements

The comparison of successful agreements (Croatia 1998, Hungary 1997, Poland 1997-1998 and Slovenia 2003) supports the recently raised doubts on the accuracy of classical veto actor theories and gives credit to Proposition 4. This makes two broad claims. First, inclusive policymaking may increase both the resoluteness of individual executives, i.e. the resilience of their policies to political shocks, such as changes in government or political preferences, as well as their decisiveness, that is, the adaptation to changing socioeconomic circumstances. Second, unconstrained executives may have a double disadvantage. They fall prey to institutional disproportionalities, so allocate gains and losses unevenly, and fail to put in place the incentives to stick to a reform's original objectives. In this case, both the executive's decisiveness as well as resoluteness score low.

The comparison of radical reforms in Poland with those, equally progressive, that took place in Croatia supports the first statement. The two countries' political-institutional configuration and executive decision-making style were poles apart – unbounded and divisive in the former, constrained and inclusive in the latter. Apparently, the possibilities offered by multidimensional deals to constrained executives call into question the professed inverse relationship between decisiveness and resoluteness. The fact that consensual decision-making increases the costs of political opportunism, as Scartascini, Stein, and Tommasi (2008: 22) suggest, may concomitantly discourage inefficient deviations in policy and increase its political sustainability in time. Considering reforms as a process and not as a one-off event exalts the virtues of encompassing negotiations. These not only increase an executive's resoluteness in the face of political shocks, but may also elicit less opportunistic behaviour, and as a result increase its decisiveness.

Second, unconstrained executives, such as those of Croatia and Hungary in the mid-1990s, are more likely to resort to divisive policymaking to push deals through. This inadequately adapts policy to socioeconomic challenges and fails to guarantee political sustainability in time. Failure to adapt disputes the alleged advantages of concentrated over dispersed authority. Unconstrained executives are capable of bypassing tangential interests, but at the same time fall prey to narrow, core constituencies. Immergut and Anderson (2007: 36-37) impute these deviations to single-member district and other disproportionalities within the broader, but undefined dimension of political competition. The consequences are a much lower resilience of policy to political shocks and hence higher probability of reversals.

The comparison of Poland and Slovenia, on the one hand, with Croatia and Hungary, on the other, fully reveals these contradictions.

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After prolonged stalemates, both Polish and Slovenian decision-makers resorted to inclusive negotiated bargains, which may have resulted, if incorrectly handled, in the dilution of reforms. This was, however, perceived as a minor evil against the backdrop of further policy paralysis and negotiation failure.

The Plenipotentiary in Poland started operating inclusively after the long gridlock between Finance Minister Grzegorz Kołodko and Labour Minister Leszek Miller. The establishment of an independent and bipartisan Plenipotentiary put restructuring firmly on the agenda. In Slovenia, this happened twice. After the successor union ZSSS staged a massive demonstration in 1998, Labour Minister Rop was forced to shed his most radical proposals and find a concerted compromise. Following the constitutionally sanctioned rejection of Finance Minister Rop's attempt to convert salary increases into pension insurance premia, his successor, Minister Dušan Mramor established in 2003 a bilateral commission with identical rights for the state and public employee unions.

It appears that more encompassing policymaking (in 1998 in Slovenia) as well as bargaining on equal terms (in 2003) and the unbundling of reforms based on the same proposal between two politically competing governments ('Security through Diversity' in Poland) significantly increased the costs of political opportunism.

In these three cases, negotiations almost broke down a number of times, leading to the dilution of reforms and ending in concessions and side-payments (in Slovenia to trade unions and coalition partners in 1998 and to public sector unions in 2003; in Poland to a wide range of involved actors). Nonetheless, proper mobilisation against reforms happened only rarely and the contested points were of almost marginal importance. Hence, relatively innocuous concessions convinced the social partners in Poland and Slovenia to accept very encompassing deals. In neither country did implementation result in significant policy reversals.

The situation in Hungary, and especially in Croatia, was different. Whereas restructuring started in the ex-Yugoslav republic with the appointment of a Plenipotentiary when external and economic conditions improved at the end of the Homeland War, Hungarian policymakers had to first overcome an internal disagreement between the Welfare and Finance Ministries. From then on the two countries started using divisive tactics and clientelistic strategies.

This produced two effects. During legislation, both executives eagerly engaged in opportunistic behaviour. Policymakers disregarded interests tangential to their sphere of influence and were, at the same time, hijacked by their core constituencies. The reforms entailed the uneven allocation of costs and benefits, an impossible outcome in consensual political-institutional environments that require inclusive policymaking. Costly deviations from efficient practice and scarce adaptation to broader socioeconomic needs followed.

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The Plenipotentiary in Croatia bypassed trade unions by lowering their overall influence on policy and office, e.g. in the Croatian Pension Insurance Institute. It overlooked pensioner associations by disregarding the 1998 Constitutional Court's decision that established the pensioner debt. It pampered its own elite welfare stakeholders, the Homeland War veterans and other privileged categories, by promising them a plethora of advantages. It obfuscated the new benefit formula by radically lowering future replacement rates.

The Hungarian Socialist Party was definitely more constrained than the Croatian Democratic Union. Nonetheless, it interpreted reforms as an internal affair with its leftist faction, represented by the successor union MSzOSz and related state-bureaucratic structures. The innumerable concessions in terms of policy (more redistributive elements), vote (political candidatures promised to union leaders) and office (favourable composition of the Pension and Health Insurance Fund boards and facilitated appointment of board members) signalled the strategic importance of leftist voters for the executive. At the same time, the vulnerability to this core constituency generated tensions with the public in general, with the political opposition Fidesz, and even with the liberal coalition partner Alliance of Free Democrats, which voted against the inefficient reform corollary.

During implementation, both countries experienced the mobilisation of those actors who were excluded from policymaking or who opposed the deviations above. Immediate retribution followed the post-reform elections. The Social Democratic Party in Croatia struck an alliance with pensioner associations and rode popular outrage, since HDZ did not fulfil the Constitutional Court's provisions. The Alliance of Young Democrats in Hungary got rid of the two self-governing boards in one stroke, and abruptly stopped the expansion of the funded pillar, eventually eliminating its raison d'être. Instead of being circumscribed to issues that were somewhat marginal, the policy reversals gradually spilled over to the core of reforms.

Three types of reform sustainability

In a number of recently released documents, the World Bank evaluated what has been done so far in Central, Eastern and Southeastern Europe and came to the conclusion that fiscal and social sustainability of reforms may be in a number of countries at risk (Holzmann and Guven, 2008).

Proposition 3, on the trade-off between sound social policy and financial viability, and Proposition 4, on the political sustainability of reformed retirement systems, reprise and extend this argument. The two propositions posit that a 'tripod', whose legs are fiscal viability, social equity and political support, should support the successful implementation of a systemic pension reform.

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This dissertation agrees with the World Bank by claiming that Central, Eastern and Southeastern European reformers have so far failed to achieve such balance. The distributional and political consequences presented in Table VI.6 show that none for the four cases performs well in all three dimensions.

Table VI.6 Distributional and political consequences of pension reforms

		Political support/sustainability	
		High	**Low**
Distributional consequences	**Fiscal strains**	Slovenia	Hungary
	Social inadequacy	Poland	Croatia

In particular, Slovenia is one of the region's countries with the worst long-term fiscal prospects for its public retirement schemes. Even Poland is not immune from popular backlashes: the strictness of the NDC formula requires long and uninterrupted working histories to yield adequate benefits during retirement. Only a minority of the working population now meets these conditions.

All else being equal, Croatia and Hungary still manage to fare worse. Not only did inadequate policymaking generate reforms that are politically unsustainable, but the two pension systems present numerous additional problems. The unfair distribution of gains and losses in Croatia, a distinctive trait of the 1998 HDZ pension reform, is threatening to push future cohorts of retirees into abject poverty. The political budget cycles that characterised reform implementation in Hungary annulled all the fiscal savings generated through the reform, compromising once again the system's financial viability.

The following paragraphs discuss the three phenomena.

Fiscal and social sustainability

The Croatian and Polish cases are archetypical examples of excessive emphasis on financial viability at the expense of sound social policy. The respective Plenipotentiaries improved the systems' fiscal prospects by actuarially balancing the present value of future expenditures and revenues. By doing so, they penalised those exposed segments of society who do not build a sufficient contribution record. Due to bad structural labour indicators and cumulative disadvantages of women (e.g. differentiated retirement age), income maintenance or even poverty prevention may not always be guaranteed. The situation is aggravated by indexation rules to continuing pensions. Croatia applies Swiss indexation to public benefits, Poland a lower price-wage mix. Both countries index second pillar annuities to prices.

Hungary and Slovenia lie at the other end of the spectrum. Slovenian reforms were chiefly parametric and policymakers failed to solve the financial problems of the system. Despite lower overall benefits, the population is still by and large 'decommodified', a socially desirable

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but financially unsustainable outcome. Hungary did not opt for immediate radical solutions – hence replacement rates remained high – and it postponed the restructuring of the public pillar until as late as 2013. Such irresolute conduct exposed reforms to immediate policy reversals and progressive fiscal deterioration. Indexation is in both cases more generous: Slovenia protects beneficiaries with pensions indexed to wages, Hungary applies a Swiss formula to both pillars.

While Table VI.7 shows the current average net replacement rates, Holzmann and Guven (2008: 34-43) provide a dynamic simulation of future benefits for nine European post-socialist countries. In both cases, it appears that on average Hungary and Slovenia (up to a certain income level, after which the ceiling on the assessment base applies) guarantee higher replacement rates than Croatia and Poland.

Table VI.7 Replacement rates

	Current average net replacement rate (all pensions)[1]							
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Croatia (HZMO)	37.6	41.4	40.7	40.0	42.1	41.8	40.5	40.0
Hungary (ONyF)	62.0	62.0	60.3	60.2	63.8	65.1	64.8	69.5
Poland (ZUS)	52.7	54.5	56.4	57.5	57.6	57.0	59.0	55.0
Slovenia (ZPIZ)	68.1	66.3	65.9	64.5	63.7	62.7	62.5	61.3

Source: national pension institutes. [1]Public pillar only, since the funded pillar did not yet start paying out annuities.

Furthermore, the projections show that whereas full careers secure net replacement rates above the middle or high benchmarks (set at 60% and 80% of average wages) in all four cases, employees in Croatia and Poland with interrupted working histories may easily fall under the low benchmark (40% of average wages).[29]

Finally, a caveat is due. The simulations of future benefits presuppose that the funded pillars function efficiently and produce stable, consistent returns. However, this was frequently not the case, as decried by the World Bank and shown throughout the country chapters. Lower-than-projected returns would negatively affect the replacement rates of Croatia, Hungary and Poland.

As a result of the inauspicious prospects in Croatia and Poland, policymakers started a serious debate on the introduction of redistributive elements into these schemes. Whereas fine-tuning stayed in Poland within the systemic limits of the NDC pillar (higher contributions for periods out of the labour market etc), this was not the case in Croatia. The numerous *ad hoc* increases, the establishment of the 'new pensioner debt' and further tinkering weakened the system's contribution-benefit link but did not significantly improve the situation for prospective retirees. Ultimately, whether these measures are sufficient to prevent future popular backlashes, which may result from the normative delegitimation of the two systems, is still to be seen (cf. Brooks, 2006).

In comparison to social adequacy, differences in the financial viability of the schemes are even more marked. The long-term outlook was in the Slovenian case grim from the beginning, and subsequent policy reversals significantly worsened the Hungarian financial situation. Given the emphasis of Croatian and Polish policymakers on internal savings through benefit reduction, projections show that their public pension expenditures are bound to fall in the immediate future. Table VI.8 illustrates the projected pension spending in the four countries.

Table VI.8 Gross public pension expenditure, share of GDP

	2004	2010	2020	2040
Croatia	12.1	-	-	8.2[1]
Hungary	10.4	11.1	12.5	16.0
Poland	13.9	11.3	9.8	9.3
Slovenia	11.0	11.1	12.3	16.8

Source: EPC (2006: 93) and Anušić, O'Keefe, and Madžarević-Šujster (2003: 66). [1]The PAYG pillar only.

The Slovenian pension system has been running deficits since 1996, when the government slashed the contribution rate for employers. The 1999 reform, which lost its structural features due to trade union opposition, introduced parametric changes that guaranteed medium-term stability. According to the ILO, it cut one quarter of future benefits (Fultz and Ruck, 2001: 40). Worsening demographic prospects, as well as the opposition of the Democratic Pensioners Party to indexation below net wage growth, further aggravated the situation.

There is no doubt that Slovenian pensions are fiscally unsustainable and that this imbalance partly derives from the insufficient resolve in 1999 to withstand organised interest groups, especially the social partners. The solutions to the crisis are rather straightforward and entail less generous indexation, higher retirement age and active labour market policies for older workers. Eventually, the introduction of a point system would once and for all strengthen the contribution-benefit link.

The Hungarian situation is somehow different. The spate of seriously damaging amendments introduced after the 1997 reform ruined the intergenerational balance of the system. The inconsiderate cuts to contribution rates under Fidesz were recently reversed, thereby stopping the deficits from worsening. Nonetheless, it is perhaps necessary that Hungarian policymakers once again start a round of retirement system restructuring and this time create the incentives for future incumbents to stick to the original reform design.

Political sustainability

From a political viewpoint, the main difference between the deals struck in the four cases was the inclusiveness of policymaking. On the one hand, after prolonged bargaining and near negotiation breakdowns, Polish and Slovenian policymakers tabled comprehensive reform

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[29] For some projections of future replacement rates, see also Whitehouse (2007).

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proposals. The legislated output cast the distribution of benefits and diffusion of blame wide, strengthening the reforms' overall acceptability. Conversely, the Croatian and Hungarian decision-makers' main mistake was the failure to engage in an encompassing debate on the future of retirement and to consequently rewrite the underlying social contract. Hasty, clientelistic and divisive policymaking rendered both retirement systems politically unsustainable.

Poland and Slovenia experienced relatively few reform reversals since 'Security through Diversity' and the 1999 Pension and Disability Insurance Act. Slovenian reforms were somehow timid, preserving most systemic features of the old system. Interestingly, privatisation did not slip off the agenda and was reintroduced for public employees four years later. The main negative characteristic of Slovenian implementation is the continuous presence in government of Democratic Party of Pensioners, which prevented a constructive discussion on the future of pensions from re-emerging. The Polish tale is slightly more worrisome. Deteriorating consensus around pension reforms under Solidarność hastened the policymaking process to the extent that important details were left out. Increasing animosity within the political arena prevented a similar degree of consensus to resurface, thereby thwarting any serious attempt at finalising the systemic reforms. Eventually, Premier Donald Tusk's government seems on its way to unfreeze the decade-long policy paralysis.

Expectably, the Slovenian and Polish experiences pale compared to Croatia and Hungary, whose reform implementation was characterised by policy reversals, clientelistic favours and disregard for the new pension systems' logic.

In Hungary, the Alliance of Young Democrats was excluded from reforms before 1998. Consequently, its aversion to the policies enacted by the Socialist Party and drastic plans to boost the economy were lethal for the freshly legislated pension system. Premier Viktor Orbán opposed the new schemes and enacted a spate of harmful countermeasures, undermining the system's logic (by rendering the mandatory funded pillar voluntary) and its financial soundness (by decreasing employer contributions, in order to gain in international competitiveness).

Smooth implementation resumed only in 2002, after the Hungarian Socialist Party seized government again. Even though the multipillar reform was the new Premier's hobbyhorse, electoral promises prompted a renewed drift into populism. The rotting fruits of previous compromises, together with a spiralling budget deficit, urged a U-turn in social policy. Eventually PM Ferenc Gyurcsány took some steps in the right direction, but after few minor amendments, his executive's increasing weakness ended with his resignation in 2009. As a result of unrelenting criticism, further structural reforms are on the agenda but these have not yet led to any concrete corrective action.

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The implementation of Croatian reforms followed a similar course. The public pillar was the object of continuous and detrimental amendments. The alliances of pensioner associations and the Croatian Party of Pensioners with both centre-left and centre-right coalitions rendered such involution possible. Their inflexible stance and excessive demands were a direct reaction against HDZ's disregard of the Constitutional Court's decision to indemnify current pensioners as well as its obfuscation strategies, through which future benefits were radically reduced.

Eventually, under PM Ivo Sanader, the Croatian Democratic Union solved both the old and new 'pensioner debt' problems by granting *ad hoc* reimbursements to older retirees and supplements to pension benefits for those cohorts retiring after 1999. This forced the Pensioner Party to reduce its demands; however, the amendments already broke the strict contribution-benefit link established with the 1999 reform. Furthermore, costly populist measures were all steps into the wrong direction. Such tinkering not only generates disincentives to work longer and save for retirement, it fails to ameliorate the condition of workers with interrupted employment histories and insufficient contributions. If corrections are not urgently applied to public schemes, labour markets and financial regulation, popular backlashes against lower-than-expected benefits may verisimilarly erupt.

The future of reforms

Although Table VI.6 indicates that none of the four cases seems to be correctly supported by the 'tripod' consisting of fiscal viability, social adequacy and political endorsement, they fare very differently with respect to prospective reform options.

By virtue of the political support enjoyed by their pension systems, Poland and Slovenia still appear to have some available room for manoeuvre. Due to the initial difficulties, the public started to question 'Security through Diversity'. Notwithstanding, the Polish public scheme enjoys good fiscal prospects and has retained its systemic coherence. Once the final pieces of missing legislation will be in place, it will be just a matter of introducing greater redistributive elements in line with the state's financial capabilities. Slovenia has the inverse problem. Insufficient resolve to cure its fiscal problems requires that policymakers once again slash future benefits. However, the system is still defined benefit and the retirement age is low. If the political obstacles represented by the Democratic Party of Pensioners will be removed and trade unions given the right incentives, a systemic reform of the Slovenian pension system, concerted with the social partners, does not seem out of reach.

A different fate seems to await Croatian and Hungarian policymakers. Due to multiple detrimental amendments, the Croatian pension system's internal logic has been broken and, at the same time, neither the public nor private schemes guarantee adequate benefit levels.

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Although the Croatian Pensioner Party does not pose any serious threats and the unions remain weak, the government will still have to introduce further redistributive elements in order to avoid a foreseeable popular backlash. Given the significant budget constraints, this does not seem to be an easy task. Finally, Hungary seems to enjoy the worst prospects of all. The only remarkable achievement of its 1997 half-hearted reform was restored fiscal stability, and this was swept away during subsequent populist waves. More worryingly still, the country sunk into a severe financial and political crisis during 2008 and the animosity of electoral competition does not seem to have abated. The possibilities to introduce further restructuring and obtain broad political endorsement are at the moment almost nonexistent.

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Annex I. List of acronyms

APEH – Tax Finance and Inspection Office

AWS – Solidarity Electoral Action

Demos – Democratic Opposition of Slovenia

DeSUS – Democratic Party of Pensioners of Slovenia

ESS – Economic and Social Council (Slovenia)

ESV – Economic and Social Council (Croatia)

Fidesz – Alliance of Young Democrats

Fina – Financial Agency

FUS - Social Insurance Fund

FZZ – Trade Unions Forum

Hagena – Agency for Supervision of Pension Funds and Insurance

Hanfa – Croatian Financial Services Supervisory Agency

HDZ – Croatian Democratic Union

HNB – Croatian National Bank

HSLS – Croatian Social Liberal Party

HSU – Croatian Pensioners Party

HUS – Croatian Trade Union Associations

HZMO – Croatian Pension Insurance Institute

HZZO – Croatian Health Insurance Institute

IGTE – Polish Chamber of Pension Funds

IKE – Personal Pension Account

KAD – Capital Fund, later Pension Fund Management Company

KNF – Financial Supervision Authority

KNUiFE – Insurance and Pension Funds Supervisory Commission

KRUS – Farmers' Social Insurance Fund

KSJS – Confederation of Trade Unions of the Slovenian Public Sector

LDS – Liberal Democracy of Slovenia

LiD – Left and Centre

LPR – League of Polish Families

MDF – Hungarian Democratic Forum

MIÉP – Hungarian Justice and Life Party

MNB – Hungarian National Bank

MSzOSz – National Association of Hungarian Trade Unions

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MSzP – Hungarian Socialist Party

OEP – Health Insurance Fund

OÉT – National Interest Reconciliation Council

OFE – Open Pension Fund

ONyF – Pension Insurance Fund

OPZZ – All-Poland Alliance of Trade Unions

PiS – Law and Justice

PO – Civic Platform

PPE – Employee Pension Program

PSL – Polish People's Party

PSzÁF – Hungarian Financial Supervisory Authority

PTE – Pension Fund Society

Regos – Central Registry of Insured Persons

RFMO – Croatian Workers' Pension and Disability Insurance Fund

SDDO – Union of State and Social Organs

SDL – Democratic Left Alliance

SDP – Social Democratic Party

SdPL – Social Democracy of Poland

SDS – Slovenian Democratic Party

SLS – Slovenian People's Party

SOD – Restitution Fund

SSSH – Croatian Trade Union Federation

SVIZ - Education, Training and Science Union

SzDSz – Alliance of Free Democrats

UNFE – Superintendency for Pension Funds

UP – Labour Union

UW – Freedom Union

ZAP – Institute for Payment Transactions

ZKS – League of Communists of Slovenia

ZLSD – United League of Social Democrats

ZPIZ – Institute for Pension and Disability Insurance

ZSSS – Alliance of Free Trade Unions of Slovenia

ZUS – Social Insurance Institution

ZZZS – Institute for Health Insurance of Slovenia

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Annex II. List of interviews

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