The Pension Scheme for Establishing Post-welfare State in the Czech Republic

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1. Introduction

Since 1989, the Central European countries, including the Czech Republic, have transformed from socialist to capitalist regimes. The political-economic transformation process in the Czech Republic began under the leadership of Prime Minister Vaclav Klaus (now president) who placed emphasis on implementing market mechanisms and so-called radical economic reforms from 1990 to 1997. In 1998, the Social Democratic Party (CSSD) took the post of political power from the Klaus administration, and since then the political and economic conditions of the Czech Republic have changed significantly.

A general survey of the situation in the Czech Republic from 1989 to the present shows a significant change occurring in 1998 within both the political and economic spheres. The turning point was the currency crisis of May 1997, which was triggered by the exposure of an enormous amount of bad debt in the financial sector and the related insufficient restructuring of enterprises, resulting from economic reforms that focused on macro-level factors and neglected the micro level. As a result of this economic crisis and other problems, Klaus was forced to resign at the end of 1997, and the Social Democratic Party came to power in June 1998. However, the new government faced an uphill battle for reform considering the country's hard economic situation.

While the government's main concerns during the initial stages of the economic transformation process were focused on macro-economic policy and reform, from the second half of the 1990s, (1) restructuring and privatization of state enterprises, (2) FDI incentive policies and (3) social security including the pension system became the main targets of reform. In this latter part of the transformation, restructuring and privatization of state enterprises, and FDI incentive policy reforms have generally been completed. Social security reform, however, remains unresolved and is currently one of the most pressing issues.

This paper discusses social security reform, especially pension reform, in the Czech Republic as public goods (a social stabilizer) in the framework of a new welfare state in the EU. The following section discusses the Czech Republic's old-age pension system under the transformation process from 1990 onwards, paying particular attention to specific features and problems of the scheme.

2. The pension system under the former socialist regime

The Czech pension system has its origins in the Austro-Hungarian Empire. A crucial step in the system's post-second-world-war development was the adoption of a national insurance law in 1948, which merged the existing fragmented pension schemes into a uniform one. At the same time, the financing model was shifted from a fully funded scheme to a pay-as-you-go (PAYG) scheme. Nevertheless, soon afterwards, the communist government fundamentally changed this approach. With new legislation, influenced by the Soviet system, which was passed in 1951 and 1952, insurance contributions were abolished and the system started being financed through taxation.

Eligibility criteria changed significantly in 1956 when the pension formula started to distinguish among three categories of employees. The first included the most risky occupations (miners, pilots, etc.), and this group enjoyed a shorter vesting period, higher pension and lower retirement age. Most occupations were in the third category, the occupations of least risk, for which the level of pension was 50% of the average wage over the last five years before retirement. The system incorporated an enormous amount of financial redistribution and social solidarity. Through the same legislation, the retirement age was lowered to 60 for men and 55 for women in this third labor category. A further move towards the equalization of pensions happened in 1960 when a maximum limit to pensionable income was introduced. Shortly thereafter, in line with the state family policy, the retirement age for women was set to range from 53 to 57 depending on the number of children they raised. Moreover, the minimum vesting period was increased from 20 years to a minimum of 25 years (see Table 1).

Table 1. Development of various pension system indicators, 1960-1980

	1960	1965	1970	1975	1980
Population of pensionable age as a % of total population	17.3	18.7	20	19.3	18.8
Average pension as a % of average net wage	59.6	57.5	53.9	49.3	53.9
Newly set pensions as a % of average net wage	70.3	60.2	61.2	56.5	64.2
Old age dependency ratio	20.2	24.8	31.4	33.4	34.8

Source: Biskup, J. (2001).

There was no mechanism for the indexation of pensions, which would have served to maintain their real value. Although pensions were subjected to several ad hoc increases between 1975 and 1988, they did not keep up with the price index increase during the same period. As a result, a radical social security reform was prepared in the late 1980s. One of the main changes was the differentiated indexation of pensions according to the year of entitlement. Another positive change was the lowering of the ceiling imposed on pensionable income, leading to a strengthening of the link between earnings and benefits.

3. The public pension scheme (first pillar)

It is first necessary to mention that the old-age pension scheme in the Czech Republic consists of two pillars, the first pillar being the public pension scheme and the other (referred to as the third pillar) being the private pension scheme. There is no so-called second pillar which is a common component in the systems of Germany and other European countries. Other Central European countries such as Poland, Hungary and Slovakia have introduced the three-pillar scheme under the initiative of the World Bank. In this context, the scheme in the Czech Republic can be seen as similar to that of Slovenia (see Figure 1).

Figure 1. Structure of Czech old-age pension scheme

Private pension funds	3rd pillar
Not used (under consideration)	2nd pillar
Public pension insurance	1st pillar

As in many other countries, the population of the Czech Republic is aging, as shown in Table 2. In 2005, approximately 20% of the Czech population was aged 65 or over, and the natural rate of population increase was -0.06 %. Discussion on these points will be limited here to simply say that population decline and aging are expected to continue in the foreseeable future.

The Czech pension scheme consists of an old-age pension, a disabled pension, a widow's pension, an orphan pension and others. At the end of 2005, out of the total of 2.645 million people receiving pensions, 1.942 million people, or 73.4%, were receiving old-age pensions (see Table 3).

Table 2. Basic data (2005)

Area (k㎡)	78,866
Population	10,251,000
Population density (K㎡)	130
Economically active persons	5,174,000
Persons over working age	2,053,000
Life expectancy for men	72.9
Life expectancy for women	79.1
Births	102,211
Birth rate (‰)	10.0
Deaths	107,938
Death rate (%)	10.5
Natural population increase	-5,727.0
Natural rate of population increase (‰)	-0.6
Migration balance	36,229
Rate of migration balance (‰)	3.5
Total population increase	30,502.0
Rate of total population increase (‰)	3.0
Marriages	51,829.0
Marriage rate (‰)	5.1
Divorces	31,288.0
Divorce rate (‰)	3.1

Source: MPSV (2006)

Table 3. The number of pensions paid by type of pension (thousand)

	Old-age	Full invalidity	Partial invalidity	Widow/widwer	Orphan	Other	Total
2001	1,896	376	157	72	53	26	2,584
2002	1,833	378	166	70	54	24	2,577
2003	1,891	380	173	67	55	22	2,590
2004	1,923	384	179	63	54	21	2,625
2005	1,942	385	184	60	52	19	2,645

Source: MPSV (2006) p. 44

As mentioned above, the present old-age pension scheme in the Czech Republic is a dual system consisting of a basic public pension fund (first pillar) and private pension funds (third pillar). The public pension scheme is a PAYG scheme for employees, which may be supplemented from national finances in the case of a deficit in the pension account. The scheme is a defined-benefit scheme (DB) in principle, and is managed by the Ministry of Labor and Social Affairs, and the Social Security Administration. In 2004, the contribution rate was increased from 26% of wages to 28%; which is composed of a 21.5% contribution from employees and 6.5% contribution from employers (self-employed persons pay the whole 28% of declared earnings). In 1995, the Public Pension

Insurance Act was revised to allow gradual increasing of the pensionable age (Act No. 155/95). Specifically, the former system's eligibility ages for receiving pension of 60 for men and 53 to 57 for women (the former for women having more than five children, the latter for those having no children) will gradually increase to 63 for men and 59 to 63 for women (according to the number of children). This retirement age will be reached in 2016 for men and in 2019 for women. The government is expected to further increase the retirement age to 65 for men and 63 to 65 for women by 2030. The insurance period for pension assessment is currently 25 years, but the government is expected to gradually extend this period to 35 years by 2018 starting in 2010. At the end of 2005, old-age pension recipients numbered 1.942 million and the average monthly pension received was 7,755 CZK (for full recipients it was 7,953 CZK) (see Tables 3 and 4). The calculation standard for premiums is based mainly on average gross income for the preceding 10 years. In 2002, the indexation of minimum pension was changed to a combination of 100% of prices and one-third of real wage growth. Moreover, the pension amounts are calculated by the base of the regular increases of the dual reduction limits. For example, the first reduction limit in 2005 was 8,400 CZK, whereby for amounts less than 8,400 CZK, there was no reduction, and for amounts between 8,400 CZK and 20,500 CZK, the reduction rate was 30%. For amounts over 20,500 CZK, the reduction rate was 10%. This scheme reflects the philosophy of the redistribution of income, which is one of the most important factors for building a welfare state in continental Europe. In 2005, the replacement rate was 40.8% in gross base and 53.9% in net base. Over the long term, the replacement rate is expected to gradually decrease, although recently the rate has risen slightly due to the country's good economic performance (see Table 5).

Table4 Average monthly amounts of solopaid out pensions(CZK)

	year	Old-age,total	full-recipient old-age	Full disability	Total
Total	2001	6,814	6,908	6,638	6,389
	2002	6,841	6,949	6,666	6,398
	2003	7,083	7,226	6,911	6,616
	2004	7,280	7,454	7,088	6,797
	2005	7,755	7,953	7,537	7,238
Men	2001	7,594	7,682	7,172	7,040
	2002	7,627	7,731	7,192	7,045
	2003	7,909	8,044	7,449	7,285
	2004	8,141	8,306	7,628	7,487
	2005	8,671	8,860	8,096	7,969
Women	2001	6,195	6,278	5,977	5,841
	2002	6,221	6,319	6,015	5,854
	2003	6,483	6,571	6,243	6,053
	2004	6,610	6,774	6,415	6,216
	2005	7,042	7,227	6,840	6,621

(Source)MPSV(2006)p.53.

Table 5. Replacement rate (CZK, %)

Year	Average pension	Average wage (gross)	Average wage (net)	Replacement rate (gross)	Replacement rate (net)
2001	6,352	14,640	11,324	43.4	56.1
2002	6,830	15,711	12,082	43.5	56.5
2003	7,071	16,769	12,807	42.2	55.2
2004	7,256	17,882	13,601	40.6	53.3
2005	7,728	18,954	14,339	40.8	53.9

Source: MPSV (2006) p. 55

Table 6. Number of pensioners in relation to insured persons (thousand)

Year	Number of insured (A)	Number of pensioners (B)	(B)/(A) %
2001	4,694	2,584	55.0
2002	4,709	2,578	54.7
2003	4,666	2,591	55.5
2004	4,767	2,626	55.1
2005	4,826	2,645	54.8

Source: MPSV (2006) p. 46

Table 7. Pension account (billion CZK, %)

Year	Revenue	Expenditure	Balance	Expediture/GDP
2001	180.2	196.1	−15.9	8.5
2002	192.2	206.3	−16.1	8.7
2003	202.8	220.3	−17.6	8.8
2004	235.8	225.2	10.6	8.3
2005	250.1	241.2	8.9	8.3

Source: MPSV (2006) p. 42

Since 2000, due to the recent good economic performance, the relation between the number of contributor and recipient shows an interesting trend contrary to what may be expected in an aging society. Following the CSSD's introduction of an FDI incentive policy in 1998, a significant amount of foreign investment has entered the Czech Republic, with most of this investment going to the manufacturing sector, particularly the automobile and electricity sectors, which contribute strongly to GDP and employment.[1] This can be considered a prime factor in the increased number of pension-contributing employees shown in Table 6.

The country's good economic performance served not only to increase the number of contributor, but also to raises wages. In addition to this economic effect, the government increased the pension contribution rate from 26% to 28%, which has resulted in an improved pension financing balance since 2004. In 2005, total pension expenditure was 241 billion CZK (8.3% of GDP), while total pension revenue was 250 billion CZK. In 2004 and 2005, the pension account was a surplus (see Table 7), in contrast to the deficit that occurred in past years beginning in 1997, the year of the economic crisis

4. Private pension funds (third pillar)

In 1994, a supplemental pension insurance law was passed by the Czech Parliament, and a state-subsidized supplementary pension insurance scheme (third pillar) that utilized private pension funds operated by private financial organizations (banks, investment funds, etc.) was established. Under the initiative of the Klaus cabinet, "coupon privatization" was implemented, under which special coupons exchangeable for stock in state enterprises were distributed among the Czech people. Although citizens were able to buy and sell stocks directly, they generally lacked the knowledge and understanding required for purchasing and selling stocks, and therefore most people used the services of investment fund companies as financial intermediaries. Consequently, these investment funds absorbed most of the coupons distributed, and they became major stockholders and wielded significant influence on the Czech economy.

In those days, the right-wing Civic Democratic Party (ODS) led by Klaus as well as domestic and foreign investors insisted on privatization of the existing basic pension scheme, and they intended to capitalize on the supplementary pension insurance though the introduction of pension funds such as investment funds. However, establishing pension funds in a climate having soft regulations and little enforcement of the investment fund law led to the failure of coupon privatization. Activities surrounding the funds were very opaque, and one scandal succeeded another. As a result, foreign investors successively withdrew from the Czech Republic's capital market, which was a major factor behind the above-mentioned economic crisis of 1997. The pension fund scheme, therefore, essentially became a state-run entity, which was greatly different from the one envisioned by Klaus and his supporters. [2]

The structure and contents of the third pillar scheme are as follows. Participation in the scheme is voluntary and anyone aged 18 or over is eligible. As of 2006, around 3.61 million people (70% of the labour force) were taking part in this scheme (in 1995, there were 1.29 million participants) (see Table 8). The reasons behind this high participation rate are a state allowance and a tax advantage, which allowed part of the contributions to be deducted from personal income tax. People aged 50 to 59 are the dominant participating group with a share of 29.5%, and those aged 40 to 59 account for almost 50% of the participants, which means there is a large portion of participants who have a relatively short time before retirement. Regardless of the age category, women tend to participate more than men (see Table 9).

This scheme is a defined contribution (DC) system run on a fully funded basis by pension funds and life and capital insurance companies. As of April 2007, 10 pension funds remained active on the market. There were 44 funds in 1995, but liquidation of poorly performing funds or integration of separate funds has been carried out under the direction of the Ministry of Finance and the Securities and Exchange Commission (SEC).

The total assets of the pension fund exceeded 145.9 billion CZK at the end of 2006, which is almost 22.5 billion CZK more than at the end of the previous year. It was just 6.3 billion CZK in 1995 (see Table 8). This is considered to be largely a result of the strategy of investors, as they turn to pension funds because interest rates of other investment options have generally been below those of the pension funds. As their assets grow, pension funds represent an increasing share of GDP assets. In 2006, this share was approximately 4.5%. Pension fund profits are subject to the direct influence of equity and bond markets, which in 2006 was not as positive as it was in the preceding year. Although in 2006 pension funds generated profits of 4.14 billion CZK, this value did not exceed the profits seen in 2005. A large part of the pension funds' total assets (77%) is held in portfolio bonds, followed by equity (7.5%), and fixed term deposits (6.7%) (see Table 10).

Due to the modest operation, the level of profit from pension funds is not high. Nominal yields fluctuated between 3.2% and 4.2% from 2000 to 2005, but due to the CPI inflation, participants' real annual gains were between -0.7% and 3.1% (without the state allowance) (see Table 11). Pension funds are obliged by law to guarantee a non-negative rate of return for participants, which means lower yields in compensation for higher investment security. Therefore, most participants regard this investment scheme as a form of long-term savings just because of the state allowance they receive for joining in the plan.

Average contribution rates are 2.5% of a pension fund member's monthly income, with the state contributing an additional 1%. Therefore, if we add the mandatory 26% contribution for the public pension scheme, private fund members have 31.5% of their average income being contributed to pension. In 2001, the average monthly contribution was 431 CZK per member and 102 CZK per member from the state. The state subsidy amount depends on the member's contribution amount. For example, in the case of a 100 to 199 CZK monthly member contribution, the state pays 50 CZK as a fixed amount, plus 40% of the member's contribution that exceeds 100 CZK. In the case of a monthly member contribution of 500 CZK or more, the state pays a fixed 150 CZK. The high level of state support is the reason why it is said to be a state-subsidized pension fund scheme.

Table 8. Outview of pension funds

Year	Participants (thousands)	Total assets (million CZK)	Total contribution (million CZK)	Operation cost to total assets (%)	Profit (million CZK)	Annual contribution per capita (CZK)	Annual stae contribution per capita (CZK)
1995	1,290	6,342	4,500	8.95	134	262	93
1996	1,564	23,268	11,400	3.31	430	305	103
1997	1,637	21,401	18,900	4.15	1,175	333	97
1998	1,740	29,609	23,900	3.85	1,749	333	95
1999	2,144	37,049	29,600	2.54	1,701	324	92
2000	2,379	44,090	36,900	2.53	1,387	337	93
2001	2,508	54,955	46,307	2.05	1,735	348	92
2002	2,597	68,927	58,147	2.24	2,262	354	90
2003	2,662	82,066	69,888	1.80	2,377	383	96
2004	2,950	102,104	85,603	1.45	3,206	397	98
2005	3,284	123,416	102,573	1.37	4,567	408	99
2006	3,611	145,947	123,534	1.38	4,124	431	102

Source: Calculated by author from PF (2007)

Table 9. Particiants by age (%)　(%)

Age	Men	Women	Total
18-29	6.17	5.99	12.16
30-39	9.53	9.56	19.09
40-49	9.53	10.93	20.46
50-59	12.55	14.36	26.91
over60	9.48	11.90	21.38
Total	47.26	52.74	100

Source: Calculated by author from PF (2007)

Table 10. Pension funds

Pension funds	Total assets (million CZK)	Total reserve (million CZK)	Profit (million CZK)	Asset share (%)		
				State bonds	Corporate bonds	Security
Allianz penzijni fond	5920	48	208	88.6	5.0	0
AXA penzijni fond	31046	350	972	46.6	22.3	5.61
CSOB penzijni fond Progres	3655	14	96	77.2	9.7	4.25
CSOB penzijni fond Stabilia	13080	103	438	70.3	15.3	3.36
Generalni penzijni fond	1286	10	64	47.0	37.0	10.00
ING penzijni fond	17593	112	747	73.4	14.1	7.20
Penzijni fond Ceske pojstovny	32472	190	1223	52.6	27.2	12.90
Penzijni fond Ceske sporitelny	20298	98	672	67.9	5.8	4.60
Penzijni fond Komercni banky	19908	183	652	77.4	10.3	2.60
Zemsky penzijni fond	678	4	38	37.8	48.5	6.20

Source: Calculated by author from PF (2007)

Table 11. Average yields of pension funds

Year	Average nominal yields	Average CPI (%)	Average real yields (%)
2000	4.2	3.9	0.3
2001	4.0	4.7	−0.7
2002	3.7	1.8	1.9
2003	3.2	0.1	3.1
2004	3.6	2.8	0.8
2005	4.1	1.9	2.2

Source: PF (2007)
Note: Data does not include the state allowance.

5. Features and problems of the pension system

An outline of the old-age pension system in the Czech Republic has been described above. Specific problems of the system are discussed in this section.

(1) Low birth rate and aging population

The Czech Republic is projected to face rapid ageing in the coming decades, due particularly to the country's low fertility rate. The dependency ratio is projected to rise from 20% in 2005 (the EU average was 24%) to 22.2% in 2010, 35% in 2030, and 55% in 2050, which is above the forecast EU average of 52% and one of the highest increases among the 25 EU countries (see Tables 12 and 13).

These forecasts are not only significantly higher than those for Eastern Europe as a whole, but they approach levels found in Northern Europe, France and Britain. As shown in Table 12, the working-age population (age 15 to 64) will face an increasing burden to support the elderly population.

Table 12. International comparison of ratio of percentage of population aged 65 and over to percentage of population aged 15 to 64

	2010	2030
Czech Republic	22,2	36,7
Eastern Europe	19,1	31,0
Northern Europe	24,7	35,3
Southern Europe	27,3	40,7
Western Europe	27,9	42,5
France	25,0	40,1
Germany	30,8	44,6
Italy	32,4	49,4
Spain	25,2	37,9
Britain	24,8	35,0

Source: United Nations, World Population Prospects:The 2004 Revision (2005)

Table 13. Age structure of the population (thous)

Year	Age 0–14	Age 16–64 A	Age 65 and over B	Age 0–14 %	Age 15–64 %	Age 65 and over %	Dependency rate(B/A)
2001	1622	7170	1415	15.9	70.2	13.9	19.7%
2002	1590	7196	1418	15.6	70.5	13.9	19.7%
2003	1554	7234	1423	15.2	70.8	13.9	19.7%
2004	1527	7259	1435	14.9	71.0	14.0	19.8%
2005	1501	7293	1456	14.7	71.1	14.2	20.0%

Source: Calculated by the author from MPSV (2006)

If the Czech Republic continues to use a PAYG public pension system, the country will face increasing difficulties in maintaining the system as working people will be required to pay higher premiums to support a proportionally larger segment of pensioners consequential to the low birth rate and aging population. Although a PAYG system is stable when a population composition remains constant and its revenue source steady, it is vulnerable to these difficulties when the aged portion of the population increases. In the scenario that there is no change made to the present scheme, the system will go into the red in the 2020s and start to accumulate debt by about 2030. In theory, by the end of the century, the overall pension debt could reach 260% of GDP. The Ministry of Labor and Social Affairs predicts that the rate of pension recipients to contributors will exceed 90% in 2050 under the present system (Bezdek, 2006). This is one major reason why it has been argued that the PAYG system, which constitutes the basic pension system of the Czech Republic, should be reconsidered.

(2) Political actors

Just after the general election in 1992, the political situation was relatively stable for two years. However, no party has an absolute majority in Parliament. The Civic Democratic Party (ODS), a leading party on the right, and the Social Democratic Party (CSSD), a leading party on the left, have taken turns in power through various coalitions. Consequently, every cabinet since the 1992 elections has had difficulty passing important legislation. In this context, radical pension reform such as seen in Hungary, Poland and Slovakia has not been possible thus far in the Czech Republic.

Table 14. Political parties in Parliament (as of Feb. 2009)

Political Party	Seats
Civic Democratic Party (ODS)	79
Christian Democratic Union – Czech People's Party (KDU-CSL)	13
Green Party	4
Czech Social Democratic Party (CSSD)	71
Communist Party of Bohemia and Moravia (KSCM)	26
Unaffiliated members of parliament	7
Total	200

The political situation in the early 1990s that led to the introduction of the first and third pillars was as follows. The situation in social security was proclaimed by the ODS as a shift away from the paternalistic welfare state and universal provisions toward as efficient and targeted welfare policy. However, the ODS was not interested in relying on state revenue and opposed requests from the CSSD and trade unions for a public pension fund that would capitalize on the current surplus of contributions. Through a political compromise, the ODS agreed to introduce the current scheme with a PAYG basic pension and a state-subsided type of supplementary pension insurance. In spite of huge pressure of trade unions, no occupational pension scheme (what we refer to as the second pillar) was adapted in those days, as the ODS argued it would be an infringement of the "civic" principle. The fact that the Czech Republic did not adopt a pure occupational scheme (Bismarck type) but choose instead a hybrid scheme relatively close to universal minimum benefit based on social insurance (Beveridge type) is significant contrast to the approach taken in Hungary and Poland.

The positions on pension reform of the four major parties are as follows. [3] The ODS prefers a flat-rate pension benefit. The party intends to reduce the role of the first scheme on flat-rate pension benefit to 20% of the average wage, increase the statutory age to 70 or 71, and abolish the early retirement system. The ODS in the long-term is looking toward the American model. The CSSD prefers a notion-defined contribution scheme (NDC) within the PAYG system. The scheme guarantees minimum benefit, and maintains the statutory age of 65 for regular pensions. The party expected replacement rate 60% (48% of NDC, with 12% of additional scheme). The Christian Democratic Union-Czech People's Party (KDU-CSL) prefers a partial opt-out of the current scheme. The party seeks parametrical reform of the PAYG system (first pillar), strengthening the equivalence of newly set pensions, and increasing the statutory age up to 65. The party is expected to introduce a second pillar scheme, which, in combination with maintaining the third pillar, would gradually reduce the role of the first pillar. The Communist Party of Bohemia and Moravia (KSCM) prefers parametric optimization. The party intends to maintain the current PAYG system considered sustainable up to 2023-2030, allocate large additional financial resources, increase the contribution rate only in 2040 by 3% and increase the statutory age up to 65, but the party will start the policy more lately. Needless to say, the different views among political parties make consensus for reform a difficult reality.

In spring of 2004, the government established a special team for pension reform, in which five parties participated to draft legislation for reforms. [4] However, following lengthy discussions, the team failed to reach any consensus. Bruno Amable pointed out the difficulties behind pension reform as follows (Amable, 2003):

"Why is such a limited change taking place? The path dependence story would insist on the fact that welfare systems are embedded in national regulations which are difficult to change without substantial transformation in the structure of interest groups…Systems where power is concentrated have more scope for radical change, whereas systems where power is shared more widely must in general establish compromises. Also, reforms of PAYG system are bound to hurt important vested interests, which limits the scope for radical change."

(3) EU accession

In 2004, the Czech Republic and other Central European countries including Hungary, Poland, Slovakia and Slovenia joined the EU. The EU has discussed and explicitly defined "the open method of co-ordination" on pension reform in the Lisbon European Council in March 2000, and agreed on common objectives in the Laeken European Council in December 2001. As of September 2002, member states are required to submit national strategy reports or national action plans. The commission examines national reports and drafts, and a joint report was to be adopted by the Commission and the Council in March 2003. Towards common objectives, member states must set targets that are assessed using commonly agreed indicators. The common objectives on the pensions are "adequacy" (meeting social objectives), "financial sustainability" (making sure they are affordable) and "modernization" (adapting to changing needs) (EU: TEC, 2006).

Although the scope of this paper does not allow for discussion of all the objectives in detail, I would like to outline the first objective, "adequate pensions," as follows:

- Ensure a "decent" living standard, a share in the economic well-being of one's country and the ability to participate in public, social and cultural life
- Provide access to appropriate pension arrangements necessary to maintain one's living standard
- Promote solidarity between and within generations

Towards achieving progress, member states must ensure their indicators and targets are as follows (EU: TEC, 2006):

- Disposable income of people aged 65 or over shall be around 90% of that people under 65
- Poverty risks are only slightly higher for people aged 65 or over
- The statutory age for pension will be raised
- Employment targets for 2010 are important for financial sustainability. The employment rate shall be 70% overall, 60% for women, 50% for older workers (ages 55 to 64). The average labour market exit age shall rise by five years

New members such as the Czech Republic, Hungary, Poland, Slovakia and Slovenia submitted national strategy reports and defined targets according to the indicators agreed to by the EU. The Czech government is implementing parametric reform of the current pension scheme according to such targets.

Among all the objectives, the author regards the first objective as most important agenda for Europe. This objective is as follows (EU: TEC, 2006, p. 4):

"Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life."

It deserves stressing that the philosophy or concept "to ensure decent standard of living" and "to build a decent society" is a most important one for European political culture (Margalit, 1996).[5] In American culture, there is a natural consensus that income disparity results from individual capability and effort. This is related to America's background as a country of immigrants, where, in theory, all citizens have equal opportunity.

On the other hand, European countries are originally class-based societies, and hence there is natural consensus to minimize income disparity and alleviate poverty through forms of social assistance such as social insurance. The European citizens are more sensitive to poverty and disparity from an institutional point of view than are Americans. Even in Japan, a recently published work on social security written by an academic group stressed that the basic objective of social security is to ensure all citizens a decent standard of living (Sekai, 2008, p. 38). Neither the Bismarck scheme nor the Beveridge scheme, neither type of welfare state type, it is necessary to build a decent society first of all. And we must point that it is not enough to build appropriate institutions but it is crucial important to make function of their institutions and moral for the weak.

6. Final remarks

It is very interesting to see the quite diverse range of outcomes among Central European countries that started pension reform at the same time. On the one hand, Hungary, Poland and Slovakia introduced three-pillar pension schemes in cooperation with the World Bank, while on the other hand, the Czech Republic and Slovenia introduced two-pillar schemes with minimum influence from the World Bank.[6] The two-pillar old-age pension scheme in the Czech Republic consists of a public pension scheme comprised of PAYG, DB and mandatory systems and a voluntary, DC-type private pension fund scheme that has not been changed since 1996. However, in order to maintain and ensure a decent living standard for pensioners, it is necessary to introduce not only parametric reform but also radical reform, such as introducing a funded scheme partially of the first pillar and/or a new scheme of the second pillar better suited for a country with a rapidly aging society like the Czech Republic. Fortunately, for the present, the public pension (first pillar) financing is stable, and it is anticipated that no radical pension reform will not implemented after 2010 when it would be emerging the deficits of pension account.

Needless to say, the general concept of social insurance is the redistribution of income in the national economy. In the broad sense of this context, the pension scheme, as one form of social insurance, is a public good that serves to ensure a decent and stable society. In spite of the intention of Klaus and the ODS, the Czech public pension scheme reflects the idea of social insurance. This may have emerged from their background and traditional sense of values (Bezdek, 2006). Fortunately, from the perspective of the pension account balance (dependence rate versus replacement rate), it can be said that the Czech public pension scheme is stable. Though, of course, the rich are likely to claim the concept of social insurance, the fully-funded pension scheme, which pillar is introduced, the benefit gap among pensioners will increase. Because the more employees gain income, more they could receive the benefit in the context of fully-funded scheme. We must consider the new forms of the welfare state in order to build a decent society.[7]

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[1] See Ikemoto (2007).

[2] Although Klaus pushes the idea of market economy as an academic, sometimes he adopted pragmatic policy as a politician. See Ikemoto (2007).

[3] For details on the proposals of each party refer to each party's website and Martin Macha who was a main player in the initial stage of the pension reform (Macha ,1999).

[4] Vladimir Bezdek was a coordinator of the team. For details regarding the team's results, refer to his 2006 paper.

[5] "A decent society is one whose institutions do not humiliate people" "A civilized society is one whose members do not humiliate one another, while a decent society is one in which the institutions do not humiliate people" and interestingly to say, Margalit mentioned also as follows. "Thus, for example, one might think of Communist Czechoslovakia as a nondecent but civilized society" (Margalit, 1996, p.1)

[6] The proposal of the pension reform for the Transion Countries was as follows (MPSV, 2002):

Variant of pension scheme

	Variant1	Variant2	Variant3	Variant4
State guarantee	Yes	Yes	Yes	No
Individual scope	All gainfully employed of persons	All gainfully employed of persons	All gainfully employed of persons	Group of individuals according to occupation
Participation of individuals	Obligatory	Obligatory	Obligatory	Voluntary
Financing	Pay-as-you-go	Pay-as-you-go	Capital	Capital
Relation between contributions and benefits	Defined benefits	Defined contribution	Defined contribution	Defined contribution and benefit
Benefit structure	Fixed amount or tied to past earnings and period of insurance	Tied to the amount of contributions paid and age of retirement	Tied to amount of contributions paid	Tied to amount of contributions paid
Solidarity	Among generations and income-related	Among generations	None	None
Tax advantage	Yes	Yes	Yes	Yes
Administration of the system	State or public	State or public	Private	Private

(Source) MPSV(2002).

Proposal of EU and World Bank

	First Pillar	Second Pillar	Third Pillar	Fourth Pillar
EU Proposal	Variant 1 or Variant 2	Variant 4	Individual provision	
World Bank Proposal	Variant 1 or Variant 2	Variant 3	Variant 4	Individual provision

(Source) MPSV(2002).

[7] It is difficult to define and evaluate a "decent" society, however, some indexes that may be useful in this regard are as follows:

Risk of poverty among older people (%)

	Poverty rate of people aged ceiling at 60% of the median			0－64 ceiling at 60% of the median
	men	women	total	
CZ	1	6	4	9
PL	4	7	6	18
HU	6	12	10	12
SK	12	13	12	22
SI	11	23	19	9
DE	11	19	16	15
UK	21	27	24	17
SWE	9	18	14	11
EU25	15	20	18	16

(Source) EU:TEC(2006).

Income of people aged 65 or more(%)

	Relative median equivalised income of people aged 65 and more compared to those aged 0-64			Source of household income of people aged 65 and more			
	Total	Men	Women	Pension	other social benefits	Income from work	other sources
CZ	83	85	82	78	4	14	4
PL	113	122	107	*	*	*	*
HU	87	92	84	75	1	20	4
SK	89	89	89	*	*	*	*
SI	87	94	83	71	2	21	6
DE	88	*	*	*	*	*	*
UK	74	76	73	69	2	17	12
SWE	77	83	73	83	7	8	3
DK	71	74	71	76	23	0	0

(Source) EU:TEC(2006).

The employment rate (%)

	Total employment rate		Female employment rate(15-64)	
	2004	Change2001-2004	2004	Change2001-2004
CZ	64.2	-0.8	56.0	-0.9
PL	51.7	-1.7	46.2	-1.5
HU	56.8	0.6	50.7	0.9
SK	57.0	0.2	50.9	-0.9
SI	65.3	1.5	60.5	1.7
DE	65.0	-0.8	59.2	0.5
UK	74.7	0.2	70.0	0.6
SWE	72.1	-1.9	70.5	-1.8
DK	75.7	-0.5	71.6	-0.4
EU25	63.3	0.5	52.6	1.4
2010target	70.0		60%以上	

(Source)EU:TEC(2006).
(note) 2010 target is agreed at the Lisbon and Stockholm.

Evolution of older workers' situation in the labour market (%)

	Employment rate55—64 (2004)	Change1995—2001	Change2001–2004	Decline of employment rate from 50–54 to 55—59	Decline of employment rate from 55–59 to 60–64
CZ	43	0	6	−23	−38
PL	26	−5	−1	−20	−15
HU	31	6	8	−22	−33
SK	27	0	4	−30	−31
SI	29	2	4	−27	−28
DE	42	0	4	−13	−36
UK	56	5	4	−11	−26
SWE	69	4	2	−6	−20
DK	60	7	2	−3	−38
EU25	41	2	4	−17	−29

(Source) EU:TEC(2006).

Gross public pension expediture as a share of GDP %

	2004	2010	2020	2030	2040	2050
CZ	8.5	8.2	8.4	9.6	12.2	14
PL	13.9	11.3	9.7	9.2	8.6	8
HU	10.4	11.1	12.5	13.5	16	17.1
SK	7.2	6.7	7	7.7	8.2	9
SI	11	11.1	12.3	14.4	16.8	18.3
DE	11.4	10.5	11	12.3	12.8	13.1
UK	6.6	6.6	6.9	7.9	8.4	8.6
SWE	10.6	10.1	10.4	11.1	11.6	11.2
DK	9.5	10.1	11.3	12.8	13.5	12.8
EU25	10.6	10.3	10.7	11.9	12.8	12.8

(Source) EU:TEC(2006).

Public pension contribution to gross pensions

	2004	2010	2020	2030	2040	2050
CZ	105	108	105	93	73	63
PL	55	71	83	87	92	99
HU	74	61	52	49	42	40
SK	90	75	69	61	56	49
SI	85	91	86	74	63	58
DE	68	69	67	68	68	68
UK	87	90	90	80	76	73
SWE	72	74	71	67	63	65
DK	*	*	*	*	*	*
EU25	80	81	79	74	71	72

(Source) EU:TEC(2006).

Gini Coefficient

	Survey year	Coefficient
CZ	1996	0.254
PL	1999	0.316
HU	1999	0.244
SK	1996	0.258
SI	1998-99	0.284
DE	2000	0.247
UK	1999	0.360
SWE	2000	0.250
DK	1997	0.247

(Source)Fact Sheet, FS07/04-05,UN
Legislative Council Secretariat,2007.