EUROPEAN EXPERIENCE IN UKRAINIAN PENSION SYSTEM’S REFORMING

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Abstract  
Global economic, social, demographic, scientific and technological changes influence the pension systems. Despite that current problems of Ukrainian pension system aren’t as deep as in some countries of East Asia and the Pacific region, India, several Latin America’s countries and Albania, Ukraine faces the need of pension system’s reforming. In this case, by the authors’ opinion, Ukraine has to focus on leading European countries’ experience. That’s why, the aim of the article is to consider advantages and disadvantages of pension systems of Denmark, the Netherlands, Switzerland, the United Kingdom and Poland, to analyze the needs of Ukrainian pension system’s reforming in current changing conditions, to discover its main problems and find the best possible ways of their solution, according to existing European experience. The article contains of introduction, three main chapters, in which history and current state of pension systems’ development are analyzed, several leading European pension systems are discussed, and Ukrainian pension system model is researched, and conclusion.  
Keywords: old-age dependency ratio, pension index, pension scheme, pension system, professional system.  
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1. Introduction  
Global economy changes the sustainability of pension systems. Fast economic and social changes influence the demographic situation. Scientific and technological progress stimulates expected lifetime and quantity of the elderly.  
The aim of pension systems reforming is to restructure the existing schemes and to meet the needs of new social-economic situation.  
In order to investigate possible opportunities of best pension systems’ reforming application in Ukrainian reality the advantages and disadvantages of pension systems of Denmark, the Netherlands, Switzerland, the United Kingdom and Poland were analyzed.
The reasons for Ukrainian pension system’s reforming were outlined, its detailed analysis was carried out, main problems and the ways of their solution were identified.

2. History and Current State of Pension Systems’ Development

Modern pension system developed significantly during the last two centuries due to the provision of decent living standard for people after retirement age. Although elderly support institutions appeared long ago, they were isolated, provided the occasional support for a small part of the population and existed on the charity basis (free lunches in ancient Rome, organization of single elderly people settlements (Caesare 370), shelters for the elderly (Rome, VI century)). Other institutions were created only for a small part of the population: military pensions from Julius Caesar, pensions for special merits (champions of the Olympic Games), pensions for monarchs, wealthy individuals. Several countries had introduced social insurance schemes to cover the risks of workers' old age in certain sectors after the industrial revolution (Heijdra and Romp 2009).

The fundamentals of the modern pension system originated at the end of the 19th century and developed in two directions: the solidarity system and the support of pensioners on property status basis. Otto Bismarck introduced solidarity system in Germany in 1889. The arguments for solidarity system introduction were universality, self-sufficiency, lack of de-incentives to work and savings. In 1891, Denmark began to introduce the support for retirees on property status basis. The benefits of solidarity system were a small amount of retirement income and increased effectiveness in combating poverty (Kolmar 2007).

All state pension schemes, at the same time components of state pension systems, were moderate and provided income in the amount of 15-20% of the average salary, at the first half of the 20th century. Life expectancy after retirement was only a few years at that time. Such moderate income-based pension payments in Scandinavian countries and countries of the British Commonwealth of Nations reflected the true objectives of state pension schemes, which provided minimum funding to reduce poverty (Groezan et al. 2009).

The period after World War II was characterized by an increasing trend in population and real wages. Therefore, population coverage by state pension provision and the amount of benefits increased in the 1960s, due to pension system’s component addition, which depended on salaries’ amount. This was the case for many countries: the USA, Canada, Switzerland, the Netherlands and Sweden, where state pension programs in the 1960s and 1970s had significantly reduced poverty. Such enthusiasm for the improvement of state pension programs in the above-mentioned countries had rapidly spread to developing countries (Herce 2003).

At the beginning of the 21st century still there are countries with a significant population part not covered by pension provision. Coverage levels in South Asia are the lowest in the world. The fragmentary pension system of India gives hope for a pension for 12% of the population (Kaushal 2014).
Another 15-20% of people, who have reached the retirement age, can count on support through programs for the protection of the poor. Pension insurance in the countries of East Asia and the Pacific region is heterogeneous. The lowest coverage rates for retirement benefits are in Indonesia (30%). Only recently, pensions have been introduced for the rural population of China. In Africa, the average retirement benefit covers less than 1/5 of the population. Others have to rely only on their own resources and informal support in the elderly. Low levels of retirement benefits are also typical for some Latin American countries – Bolivia, El Salvador, Peru (10-15% of able-bodied) (Williamson 2001). Even in Europe there is a pension system (Albania) with a coverage level of pension provision of 32% (Groesen et al. 2009).

In most developed countries, the size of public pensions is insignificant. For example, in the United States, Great Britain, Canada, Ireland, the state provides insufficient level of labor income’s replacement. In general, individuals with an average or slightly above average incomes can count on a state pension of 20-40% of their salary (Thomas et al. 2014).

Consequently, the people, who are not covered by the pension system, survive depending on the opportunities and circumstances. In agrarian countries, they mainly rely on their own resources and informal support in the elderly. Another old tool, which is actively used today, is savings. By examining developed countries’ pension system, especially with the small size of the state pension, it be seen, that incomes’ increase in the elderly is possible only at the expense of voluntary pension insurance (Creedy et al. 2015).

Modern pension systems are improved practically all over the world, and first of all in countries with highly developed social relations. This is due to the aging population trends. Therefore, together with retirement age raise fundamentally new pension systems, which disperse social risks and weaken their influence, are introduced (Alda 2017).

Consequently, multilevel pension system is widely used in the world practice. It has three components (levels) – solidarity (first level), compulsory cumulative (second level) and additional or voluntary cumulative (third level). Such combination ensures social guarantees and financial stability of the pension system. Solidary and cumulative systems are exposed to various risks. First one is vulnerable due to demographic risks and is fairly resistant to inflation. Second one conversely is weakened by inflation and stable to demographic risks. The reformed solidarity will take into account the interests of the poor, while the accumulation will stimulate the retirement savings of all citizens, especially higher incomes owners (Staveley-O’Carroll and Staveley-O’Carroll 2017).

3. Analysis of Several Leading Pension Systems of Developed Countries

It should be noted, when analyzing the world’s pension markets, that researchers consider several pension markets to be progressive. These are the pension markets of Australia, Denmark, Japan, the Netherlands, Switzerland, the United Kingdom and the United States (Thomas et al. 2014).
Pension systems features from some of the above-mentioned countries will be reflected in detail.

At the beginning of 2018, Denmark’s pension system has been a leader for more than 5 years in a ranking of pension systems in the world. Denmark has scored 80.5 points according to the latest study of “Melbourne Mercer Global Pension Index 2017” (MMGPI), which has already been conducted 9 times by the Mercer consulting firm in collaboration with the Australian Center for Financial Research (Melbourne Mercer Global Pension Index 2017).

Denmark’s multi-level pension system includes a national old-age pension (people’s retirement benefits) and a much smaller supplementary pension. The national retirement pension, the amount of which is almost two thirds of all retirement income, is compulsory, non-taxed and funded at the expense of the general taxation based on the “you pay” principle. The first pension level has a number of benefits, including the effective purchasing power of retirees, which increases with age-based tax reductions. At the second retirement level, there are professional pension schemes based on collective agreements. These schemes, in various sectors of the economy, cover about 90% of wage-earning workers with benefits reflecting contributions and investment returns (Thomas et al. 2014).

The second level involves Danish statutory pension schemes. These are supplementary pension insurance schemes, which are regulated by Danish legislation and governed by Danish Labor Market, where contributions are shared between the worker and the employer. Danish compulsory occupational pension schemes are based on collective agreements provided by social partners. The coverage of these schemes is almost universal. Denmark’s pension system also includes private pensions – voluntary, supplementary pension schemes usually managed by banks or insurance companies.

At the third level, there is a wide range of voluntary, individual life insurance and retirement plans with ambiguous coverage and different scales. Savings schemes on the third level generally end with one-time payments without an annuity obligation.

The main feature of Danish pension system is stability, which includes general savings and pension security. The state retirement age is now 65 years old and will gradually increase to 67 years in 2019-2022, due to the improvement of living conditions and the aging of the population. The problems of the modern Danish pension system are following. Pension system is rather complicated, due to the targeting of income testing, which leads to high and differentiated marginal tax rates for various pension savings and reduces transparency. Part of people does not have their own savings. There is an insignificant state pension payments level (aggregate replacement rate is 0.44) (Melbourne Mercer Global Pension Index 2017).

Despite the above mentioned problems, Denmark’s pension system is considered to be one of the best pension structures in the world. Mercer notes that Denmark has a “first-class and reliable pension system” that “is sustainable and has a high level of integrity” (Melbourne Mercer Global Pension Index 2017).
The Netherlands is known for the reliable multilevel pension system. According to MMGPI, the Netherlands scored 80.1 points from 27 countries in the world (Melbourne Mercer Global Pension Index 2017). Algemene Ouderdomswet (AOW), the principal Dutch state-funded pension, provides a generous payment of monetary compensation to all individuals, who have reached the statutory retirement age and have lived in the Netherlands for 50 years at the age of 15 to 65 years. A broad system of accumulated occupational pension schemes agreed by collective agreements covers 91% of eligible employees. Professional pension schemes usually provide benefits. These benefits combined with a public pension (AOW) represent around 70% of the average wage after 40 years of employment (Chen et al 2014). In general, the Dutch pension system is based on the AOW, which is the main state pension system funded by the “you pay” principle. The current retirement age is 65 and will increase to 67 years by 2021. The Netherlands pension system also provides nationwide pension schemes, company schemes and insurance contracts. Although legislation does not oblige employers to offer pension schemes to employees, employment contracts cover 91% of employees (Chen et al 2014). In addition, the Dutch pension system has won interest in recent years by individual savings schemes.

Hence, Dutch pension system is a genuine multilateral system that provides retirees with payments from all three levels, which include fixed-rate public pensions (AOW), professional pension schemes established under collective agreements and individual benefits established on the basis of individual savings. In our opinion, the Netherlands pension system will continue to work well in the future due to the active and timely actions of the government, despite a number of problems. The cost of pensions for the first and second pillars is increasing. It is forecasted that the dependence on old age coefficient (parity ratio of 65 years and older population to the share of 20-64 years population) will increase from 28 in 2013 to 52.5 in 2060, although these tendencies are slightly below the EU-27 average (Melbourne Mercer Global Pension Index 2017). There is a partial loss of confidence to the occupational pension system due to its vulnerability to financial market fluctuations and increased attention as well as resources to promote the employment of the elderly.

Swiss pension system consists of three levels. The first level is mandatory state pension insurance. The current statutory retirement age is 65 years for men and 64 years old for women. 65 years old retirement age for men and women is scheduled to be in 2020. The second level is high-paying professional system. It is obligatory for all employees, whose annual income exceeds the minimum level. The third level is voluntary individual retirement savings facilitated by tax regulation.

Swiss professional market is clearly regulated in terms of investment constraints and regulatory criteria. Legislation requires pension funds to return a minimum percentage of statutory minimum levels of contributions. The current minimum interest rate set by the Federal Council has been reduced from 1.25% in 2016 to 1% in 2017 (Thomas et al. 2014).
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According to MMGPI, Switzerland scored 67.6 points in total and belongs to the “B” group (Melbourne Mercer Global Pension Index 2017), which includes countries with good pension systems, but differs from group “A”, since some elements of the pension system have to be improved.

Thus, Swiss three-leveled pension system, which is characterized by a highly paid professional system, is based on one of the leading pension markets in the world. In today's dynamic conditions, the Swiss pension system is almost unchanged, although it requires close attention from the government in connection with the aging of the country's population.

In the past, the United Kingdom was characterized by a pension position, which combines “one of the least generous state systems in developed countries” with the most developed voluntary agreements. Since that time, there have been many changes. The series of reforms increased the attention to the responsibility of a person for its pension’s future.

In general, British pension system can be summed up as follows. There is a state pension. It is based on “you pay” principle. The payment is made from today’s income. Additional state secondary pension (S2P, formerly SERPS) provides income for those employees, who have not signed the contract. Also, there are professional pension schemes. They are financial arrangements provided by private companies and employers of the public sector. Since October 2012, the government has begun to apply an automatic enrollment of employees to retirement schemes. According to the schemes employers have to register qualifying pension schemes. Personal pensions include group personal pensions and stakeholders’ retirement benefits. The government introduced the reform of the state pension system together with the Pension Fund in 2013-2014, permitted by the Royal Decree of May 14, 2014. These changes meant the replacement of the current basic state pension and supplementary state pension by one higher-based level pension from April 2016.

The current retirement age (SPA) is 62-63 years for women and 65 years for men and will continue to change, while Britain continues to align the state retirement age for men and women. The 2011 Pension Insurance Act provides the establishment of a state retirement age for women up to 65 years by 2018 and for men and women up to 66 years from 2018 to 2020 (Chen et al 2014). In future, the state retirement age will be reviewed every six years and increased according to events and probable life expectancy.

Based on the results of MMGPI, the UK pension system gained 61.4 points and is part of the C + group (Melbourne Mercer Global Pension Index 2017), which means the existence of a number of good functions in the retirement system along with serious risks and disadvantages that need to be resolved. Researchers believe that without these improvements, the effectiveness and/or long-term sustainability of the British pension system can be doubted.

The United Kingdom belongs to a group of Member States, which predict an increase in the age dependency ratio below the EU-28 average. During the period 2013-2053, the ratio of this coefficient, depending on age, will increase by 16.4 points (EU-28: 24.6 points) (Melbourne Mercer Global Pension Index 2017).
Summarizing the review of the British pension system, we note that reducing the poverty of the elderly in the short term and efforts to increase pension loans should be a priority for the government and will enable to maintain leadership among the pension markets of the world.

While analyzing the reform of Polish pension system, we note that after the pension reform in 1999, the general pension system for people born after 1948 consisted of two levels. The first is the non-funded scheme of NDC, operated by the Institute of Social Insurance (Zakład Ubezpieczeń Społecznych, ZUS). The second level is the fully funded scheme of open pension funds (Fundo Fundusze Emerytalne, OFE) managed by private investment companies – general pension societies (Powszechne Towarzystwa Emerytalne, PTE). Since 2014, membership in the second level has become voluntary. All members of the OFE have had the choice either to partially pay their contributions to the pension fund, or to direct the entire contribution to the NDC accounts in ZUS. Regardless of the choice, 10 years before the retirement age, the accumulation set in the second level is gradually transferred to NDC2 (so-called creeping mechanism), in order to protect it from the risk of the financial market. Thus, both public and private elements of the Polish pension system are based on the principle of defined contributions (Egert 2013).

In the ranking of pension systems, according to the results of MMGPI, Poland occupies 19th place with a total score of 55.1 and belongs to the C group of countries (Melbourne Mercer Global Pension Index 2017). Pension systems of these countries are characterized by good functioning pension systems and serious risks and/or disadvantages to be settled, due to the risks of long-term sustainability. Pension manager at Mercer in Poland Andrzej Narkiewicz says that the Polish pension system has not changed since the 1999 pension reform in a way that could improve the situation for future pensioners, according to international standards.

As of the beginning of 2018, the Polish pension system is in a transitional period. The analysis of indicators relating to the current situation of pensioner clearly shows that recently paid pensions provide adequate protection against monetary poverty. The average income of people in the age group of 65+ is similar to the income of people under the age of 64. The income of pensioners aged 75 and over is improved through care provided at the age of 75 to improve the adequacy of pensions for this group (Melbourne Mercer Global Pension Index 2017).

It is forecasted that in Poland the dependence on old age coefficient will rise from 22.3 points in 2013 (EU-28: 30.3 points) to 61.0 points in 2053 (EU-28: 54.9 points). Poland is also a member of the group of Member States, which predicts an increase in the age dependency ratio, which is higher than the average for the EU-28. During the period 2013-2053, the ratio of old age to age will increase by 38.7 points (EU-28: 24.6 points) (Melbourne Mercer Global Pension Index 2017). Thus, the Polish pension system is a two-leveled one and is still in the process of reforming, although it has made great success in ensuring decent retirement. The only condition for getting a pension is the age. The statutory retirement age is gradually increasing from 2013, starting with 60 years for women and 65 for men.
Every 4 months, it increases by 1 month to reach the age of 67: this will happen in 2020 for men and in 2040 for women. Such changes are due to such European tendencies as aging of the population and increasing life expectancy.

4. Ukrainian Pension System Model’s Research

Under the current conditions of market relations’ development and European integration processes Ukrainian socio-economic policy is required to be directed towards the achievement of European life quality standards.

Pension reform in Ukraine is a continuation and an integral part of country’s economic reforms. Also, it is a consistent implementation of previously adopted legislative acts. The analysis of the world pension systems gives the opportunity to analyze the advantages and disadvantages of each system and reform the pensions system, depending on the current conditions of the country.

In June 2017, the Government of Ukraine faced an acute problem of unpopular pension reform. The reform envisaged the formation of a three-leveled pension system.

At the beginning of 2018, Ukrainian pension system consists of three levels. The first level is the solidarity system. Contributions are paid by all working citizens and their employers. In the current period these contributions are spent on payments to pensioners. State budget subsidies are provided. The second level is the accumulative system of compulsory state pension insurance. It is based on the principles of accumulation of insured person’s funds in the accumulation fund or in the corresponding non-state pension funds. The third level is the system of non-state pension provision based on the voluntary participation of citizens, employers and their associations in the formation of pension savings in order to receive pension benefits on conditions and in the manner prescribed by the legislation on non-state pension provision (Ptashchenko and Topol 2014).

The main problems of Ukrainian pension system at the present stage are the following. Low retirement age with early retirement opportunities is available to many citizens. In Ukraine, the average retirement age for men is about 58.5, for women it is 57.5 years. The average retirement age for the EU is 63.6 for men and 62.6 years for women.

In Ukraine, there are more than 12 million pensioners. It is about 30 p.p. of the population (Ptashchenko and Topol 2014).

There is a significant deficit of the Pension Fund. It is UAH 140 billion or 6 p.p. of GDP as of 2017, which is the second largest deficit of the pension fund in Europe compared to the size of the country's economy (Ptashchenko and Topol 2014).

The government is taking several steps to overcome the above-mentioned problems. In particular, new pension system is characterized by the distinction between the concepts of full employment experience and insurance experience. The latter is understood as a period of experience since 2000, when the introduction of a pension insurance system began in the country and a separate “pension history” was made on each citizen. From January 1, 2018, person needs to have minimum “new” insurance record of 15 years (with a general insurance
record of at least 25 years) to obtain a pension, with a gradual increase in a year until it reaches 35 years in 2028. Citizens, who have reached the age of 60 years and plan to retire, but have insufficient period of insurance, could make compensation of one to five years employment experience value by contributions to the Pension Fund, which should ensure social justice, in accordance to the current law. Such step will automatically increase the retirement age and accordingly reduce the number of retirees in the country.

The second step is to fill the Pension Fund of Ukraine (PFC), whose deficit in 2017 amounted to 140 billion UAH (Ptashchenko and Topol 2014). Based on the experience of European countries, the pension system of Ukraine should have a pension calculating depending on contributions made by a person throughout its life. If an individual does not make contributions to the pension system and then requires retirees’ payments from it, it is unfair to the regular payers. In our opinion, the problem of filling the PFCs can be solved by ensuring transparency of the economy and encouraging Ukrainians to participate in the pension programs of the second and third pillar of Ukrainian pension system.

It is impossible to analyze Ukrainian pension system by the Melbourne Mercer Global Pension Index 2017 because it has not been investigated in this rating.

5. Conclusion

Summarizing the above, we note that the Government of Ukraine, based on the experience of European governments, should ensure further reforming possibility of Ukrainian pension system through the following measures. Pension Fund of Ukraine should implement the investment activity and create cooperation conditions between non-state pension funds and insurance companies. European experts should be attracted in order to use the experience of effective pension programs. Public confidence strengthening conditions in non-state pension funds and insurance companies should be created due to their vulnerability to financial market fluctuations. Attention and resources amount to promotion elderly employment should be increased. Employers’ responsibility concluding labor agreements should be strengthened. Modern and accurate information about pension rights should be provided to the citizens. People should be assisted in making best financial pension decisions. Retirees’ electronic cabinets and online service to ensure transparency of pension payments and revenues should be created.

References


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