WELFARE STATE EVOLUTION IN CZECH REPUBLIC, HUNGARY AND POLAND: TOWARDS A NEW PARADIGM?

Cristina Matos

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Welfare state evolution in Czech Republic, Hungary and Poland: Towards a new paradigm?

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* DINÂMIA/CET-IUL, Centro de Estudos sobre a Mudança Socioeconómica e o Território e EEG, Universidade do Minho – Universidade do Minho, Campus de Gualtar, 4710 Braga, Portugal, crism@eeg.uminho.pt.

Welfare state evolution in Czech Republic, Hungary and Poland: Towards a new paradigm

Abstract:

In this paper we discuss welfare state reforms in Czech Republic, Hungary and Poland. We analyse particularly the evolution of unemployment insurance, old-age pensions and social assistance. We investigate whether welfare state reforms can be perceived as paradigm shifts. We consider such a change entailed a decrease in social insurance relative to both social assistance and individual insurance.

Keywords

Welfare state, paradigm change, Czech Republic, Hungary, Poland.

INTRODUCTION

Throughout the world, social policies changed considerably over the last decades. These changes have translated into spending cuts as well as changes of emphasis. Along with retrenchment, some authors consider welfare states are being *recalibrated* [Ferrera and Hemrijck, 2003]. Welfare state recalibration implicated particularly more means-tests and *activation*, as well as promoting supplementary systems (e.g. private pensions). It has also involved enhancing private insurance elements such as actuarial fairness and individualisation[1].

The case of Central and Eastern Europe is particularly interesting because welfare states were *recalibrated* during systemic transformation. Czech Republic, Hungary and Poland are exceptionally appealing cases. For starters, Czech welfare protection was reformed very rapidly in the 1990s. On the other hand, old-age pension reforms in Poland and Hungary involved partial privatisation.

In spite of national differences, Czechoslovakia, Hungary and Poland shared a similar social insurance and social assistance before 1989. Before central planning, their welfare state was dominated by employment-related social insurance, coupled by some occupational pension systems.

Under central planning, welfare state became “a worker’s privilege rather than a citizen’s right” [Wagener, 2002]. Firms were central in welfare state organisation; they allocated social consumption and family allowances and they calculated pension entitlements.

Poverty was not a high priority objective [Sibos, 1994]. Those who did not work received a very weak and discretionary social assistance. For example, the disabled were frequently institutionalised [Sibos and Ringold, 2005]. This residual nature of poverty protection was a source of criticism of *real socialism*, particularly in Hungary from the 1980s [Ferge, 1998].

In the early 1990s, social protection was not a priority. Still, social budgets were clearly hit by transformation crisis and social provisions were importantly reformed. Were these reforms motivated by financial concerns alone or do they reflect a change in *welfare paradigm*?

Like in Kuhn’s scientific revolutions, new values and cause-and-effect relationships are at the heart of welfare state paradigm changes. We use the term *paradigm change* to denote changes of weight in the welfare mix along with the transformation of underlying normative assertions and implicit causal relations.

[1] For pensions see Matos [2009].

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To be sure, the term paradigm has been applied in different senses to welfare state evolution. Compulsory private pension funds have been described as *paradigmatic pension reform* [e.g. Barr and Rutkowski, 2005]. Our use of the term paradigm in this paper is closer to Ferge [1998], who defines the new *social policy paradigm change* in Hungary in terms of its values (liberty, individual responsibility), and state intervention limits.

Our paper focuses on UI (unemployment insurance), SA (social assistance) and pension reforms. Although these are only a part of the welfare state[2], they make up the basic elements of social protection. On the one hand, UI, retirement income and disability are chef in social insurance and were considerably reformed in the three countries. On the other hand, SA is a central poverty alleviation instrument.

After establishing some preliminary definitions, our paper gives a brief description of major welfare state reforms. We present the countries separately, since it is important to understand the reforms are interconnected. Indeed, we should bear in mind that the welfare state is a system of interdependent entitlements. Our analysis stresses particularly changes in benefit design, such as entitlement rules, benefit determination and duration.

Afterwards, we will analyse these welfare state reforms in terms of welfare state paradigm change. We will examine, particularly, the evolution of the underlying values, the implicit causal relations and the changes of weight between social assistance, social insurance and private insurance.

[2] Although welfare state definitions vary considerably, the welfare state typically involves social protection, labour market policies as well as public services.

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1. CONCEPTUAL ISSUES: SOCIAL ASSISTANCE, SOCIAL INSURANCE AND PRIVATE INSURANCE

Social protection has two major dimensions: social insurance and social assistance [Barr, 1994]. Additionally, recent reforms have developed supplementary, individual-based, insurance. Welfare states can use different proportions of the three principles of social assistance, social insurance and individual insurance. Their main features are presented in Table 1.

Table 1 – Social insurance and social assistance provisions

	Social assistance	**Social insurance**	**Individual insurance**
Coverage	Universal	Contributors	
Entitlement	Means-tested or citizenship	Minimum record In specific events	In specific events
Benefits	Flat-rate	Employment-related	Actuarial
Aims	Fight Poverty	Income insurance	Capital insurance
Adverse effects	Poverty traps	Unemployment and inactivity traps	Adverse selection Moral hazard
Financing	General budget	PAYG	Funded

Social assistance's main aim is to fight poverty. Its benefits are universal and financed through the general budget. The flat-rate benefit can be paid under citizenship conditions or be targeted. Means-tests can be limited to income (incomes-tests) or may require the evaluation of other assets (e.g. land property).

Social insurance benefit are employment-related and paid only after a minimum contribution record is reached. The benefits are paid if a specific event is produced (e.g. unemployment, retirement, birth). Under social insurance, risks (e.g. unemployment or disability risks) are pooled collectively. The system is financed on a PAYG (pay-as-you-go) manner, since present contributions are used to pay present unemployed, disabled, retired and survivors.

Mainstream economics considers social assistance and social insurance can have a negative effect on activity rates. This impact is derived from the leisure trade-off and emerges if benefits are higher than minimum wages. Low wage earners are more sensible to these traps.

These effects can be partially captured by the net replacement rate. This is the ratio between the net benefit and net average wages. The replacement rate also reflects income insurance effectiveness. At any point in time, social insurance and social assistance will need to balance their income insurance and poverty reduction aims and the need to counter potential adverse effects.

Like social insurance, individual insurance covers only its contributors and benefits are paid upon a specific event. Unlike social insurance, it is financed on a funded manner. Additionally, it pays actuarial benefits, dependent on individual capital. As such, individuals have an incentive to continue work, since this will increase their future benefits.

Individual insurance also has potentially adverse effects. On the one hand, it is subject to adverse selection, since individuals with higher risks have higher incentives to take up insurance. On the other hand, it is exposed to moral hazard, since individuals can assume riskier behaviour if they are insured.

While the merits of social relative to individual insurance are clear in the case of unemployment risks, there are controversies over market failures in the case of pensions [Barr, 1994]. As such, private pensions have developed throughout the world. Private pension schemes are conspicuously different from public pensions.

While public pensions are usually DB (defined benefit), private pensions are expected to be DC (defined contribution). In a DC scheme, pensions depend strictly on contributions made, whereas in a DB arrangement, pensions depend on a specific formula, characteristically related to the wages earned over a specific period.

In consequence, DC templates enhance actuarial fairness, while BD settings are more redistributive. DC schemes are based on individual insurance principles, whereas DB design finds its roots on social insurance.

As stated above, under central planning, the welfare state balanced residual social assistance and firm-related insurance and collective services. We now turn to a presentation of how systemic transformation changed the balance between social assistance, social insurance and individual insurance in the three countries.

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2. CZECH REPUBLIC

Czech GDP plunged from 1990 to 1991, restarted to grow in 1993 and experienced a downturn in 1997-98. In Figure 1 we can observe employment growth followed GDP fluctuations. Indeed, real GDP growth explains 85% of employment variation. Employment losses translated into unemployment and inactivity increases along with pensioner activity decrease.

Unemployment remained low initially but grew steadily during the 1990s. Czech activity rate remain relatively high. From 1989-96, the number of pensioners increased only by 3% [own calculations based on Adam 1999]. Still, while pensioner activity was high under central planning, the number of working pensioners contracted by over 63% in the same period [*idem*].

Welfare provisions changed importantly in the early 1990s. From December 1989 to June 1992 design was oriented by emerging social concerns. Additionally, central-budget-financed provisions were transformed into a separate- social insurance budget. Pension entitlements and statutory age were unified across occupations. Means-tested social assistance was also introduced in the early 1990s.

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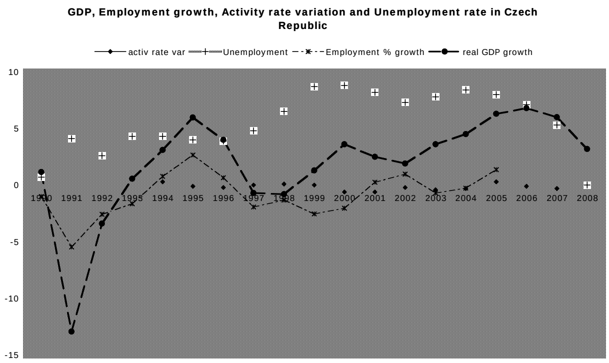
Figure 1[3]



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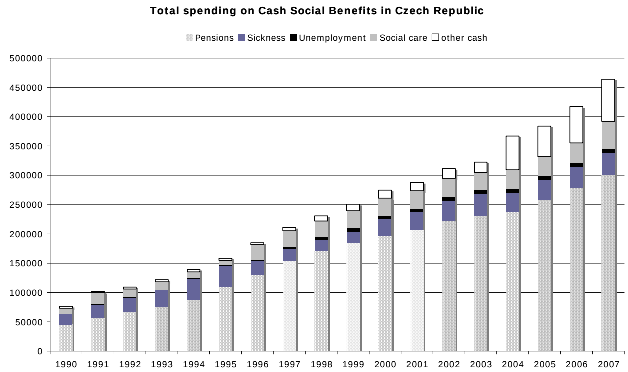


Figure 3

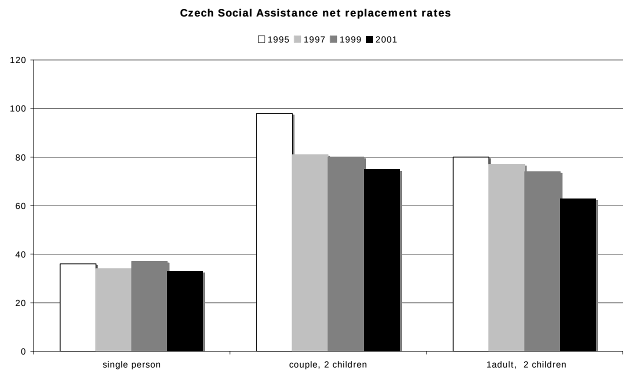


Figure 4

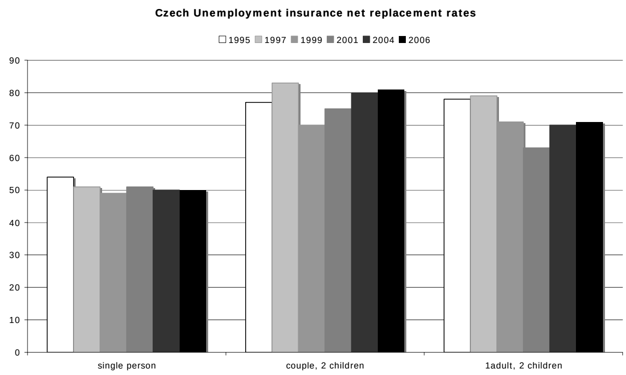
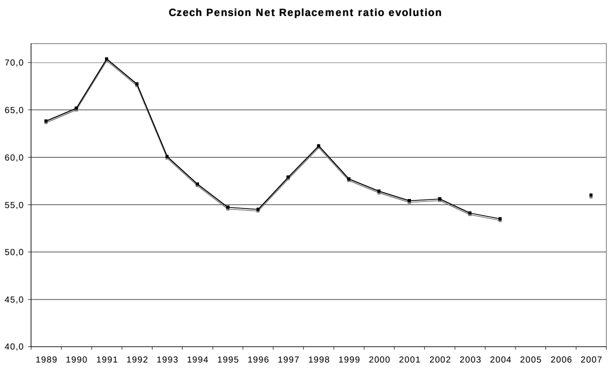


Figure 5



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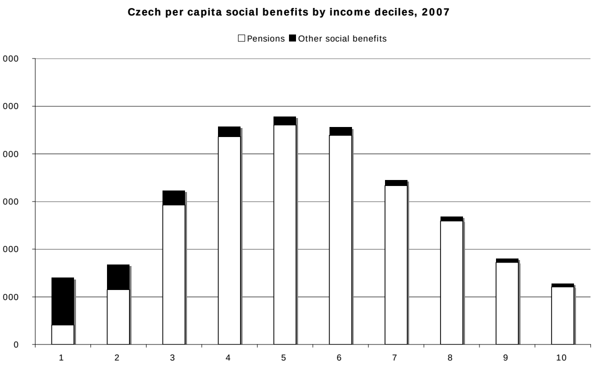

Sources: All figures from the CSO (Czech Statistical Office), except: Activity rates are from ILO; and UI and SA replacement rates are from the OECD Benefits and Wages, different years. Figure 5: Own calculations, based on CSO.

[3] Activity rates variation is calculated as percentage point variation.

Unemployment insurance was introduced in 1991. Benefits were employment related[4] with no maximum or minimum benefit. This system was universal.[5]

A second phase of welfare state reforms started as early as 1992. The then new Prime-Minister Vaclav Klaus, called for a 'market without objectives'. This should emerge from big bang price liberalisation coupled with mass privatisation.

This second phase is marked by retrenchment concerns and by changing the system philosophy. A great admire of Margaret Thatcher, Klaus additionally favoured elements akin to the British welfare state reforms, such as income-tests and citizenship-related social security provisions [Večerník, 2007].

While partly imported from abroad, welfare state reforms involved national adaptation. For example, means-tests are strictly based on income and do not include property. Contrary to the UK opting-out of the public pension system is not possible. Furthermore, although they decreased, pension net replacement ratios (Figure 5) are higher than their British levels (around 30%).

Low unemployment might have facilitated dramatic unemployment insurance reforms. From 1992 UI duration was reduced to 6 months. Although no minimum benefit level was introduced, a maximum ceiling was set at 150-180% of the minimum living standard). Unemployment insurance remained employment-related[6] but, since the maximum benefit was very low, the UI system was *de facto* flat-rate for most workers.

The impact of UI cuts was aggravated by non-indexation to inflation and unemployment benefits lost 17% of their real value between 1991 and 1996 [Adam 1999].

Pensions were also reformed. Statutory age was increased in 1995 and should progressively reach 62 for men and 57 to 61 for women.[7] The pension formula was also reformed. The new pension system is hybrid for thee reasons.

First, the pension system is a hybrid of social insurance and safety net, because it combines a flat-rate and an employment-related component. The pension reform, consistently reduced pension net replacement rates (Figure 5).

Second, benefits depend simultaneously on contribution record and on wages; the system thus combines DC and DB elements. Indeed, the wage record considered in the BD formula is augmented progressively and should reach 30 years by 2016 [Mácha, 2002].

[4] Over the first semester, they amounted to 60% of wages earned over the last 3 years, then 50%. These proportions were increased in the case of retraining (to 70%).

[5] Although the system was attributed for one year to all those having worked for at least one year, others could be entitled to 70% of the minimum living standard.

[6] In the first trimester, the unemployed received 60% of previous average wages; 50% afterwards.

[7] Women statutory age continues to depend on the number of children, as it did under socialism.

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Thirds, it combines a state-run pension system and private accounts. Voluntary private pensions were introduced in 1994. Participation developed rapidly and, as early as 2000, half the economically active had an individual account. This was particularly fuelled by tax incentives and by replacement rate decline.

Pension reform also involved new criteria for evaluating disability. From 1996, there was a decrease in the number of full disability pensions and an increase in new partial disability.

State social support benefits are paid out of general taxation and paid by decentralized authorities. Child allowances, social assistance, housing benefits, etc. are paid as multiples of social minima. Decreasing child-related benefits translated into social assistance and unemployment replacement ratios losses for couples with children.

While social protection reforms generally halted from the mid-1990s to 2004 [Večerník 2007], UI benefits were further curtailed in 1998. This reform further shrank the employment-related component,[8] and translated into decreasing UI replacement rates in 1999 (Figure 4). The maximum unemployment benefit was only limitedly increased and remained as low as 250% of the minimum living standard.

This UI cut was introduced at a time of unemployment increase (Figure 1). The situation of the unemployed was aggravated by unemployment length increase; while less than 1% of the working population were unemployed for over a year in 1993 (16% of the unemployed), this percentage increased to 4% in 2001 (over half of the unemployed) [CSO].

Aggregate social spending grew continuously (Figure 2) in spite of benefit entitlement retrenchment. This was particularly a result of pension dynamics but occurred in spite of pension replacement rates decrease from 1998 (Figure 5). Indeed, in spite of the economic downturn in 1997-98 (Figure 1), unemployment spending increased only limitedly.

“Other” cash benefits increased significantly after 2004. This is linked to social protection reforms reformulation around ‘make work pay’ [Večerník, 2007]. Measures included an increase in minimum wages as well as facilitating the accumulation of (UI and pension) benefits with wages.[9]

In the 2000s, UI replacement rates remained rather stable, while state pension replacement rate continued to decrease. This reflects simultaneously the will to promote private pension accounts and preventing early retirement. Indeed, unemployment insurance duration was increased for older workers (it is 9 months to those over 50 and a year to those over 55).

[8] In the first trimester, UI benefit is half of previous average wages, and 40% in the second semester.
[9] Pensioners can continue working; the unemployed can work up to 50% of the minimum wage.

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The combination of flat-rate pensions with a partly employment-related component makes pension redistributive from the 6th decile (Figure 6). Other benefits are clearly redistributive and are concentrated particularly at the first and second income deciles. Since UI benefits are limited at 250% of the minimum living standard, they are de facto flat-rate for higher income deciles.

The emerging pattern in social assistance results from the use of means-tests. Only a small proportion of benefits is not means-tested and can also be perceived by the upper deciles.

3. HUNGARY

Some thought that the gradual reform approach initiated in Hungary in 1968 could be continued in the 1990s. To a certain point, Antal government welfare reforms were in this line. Indeed, some defined the years 1990 to 1994 as a *social market economy* [Ferge, 1998]. In the early 1990s, social insurance was separated from state budget; UI and SA were promptly introduced.

For example, social assistance development in the early 1990s attended both growing needs and the holes on *real socialism* safety net holes.[10] Means-tested social assistance was introduced immediately. Pre-existing social provisions, such as the family allowance and medical care provision remained universal. The introduction of means-tests reduced the discretionary nature of assistance under central planning.

[10] Indeed, in 1980s, poverty rates were as high as 10 % [Sibos, 1994]. These more than doubled in 2 years [*idem*].

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Figure 7

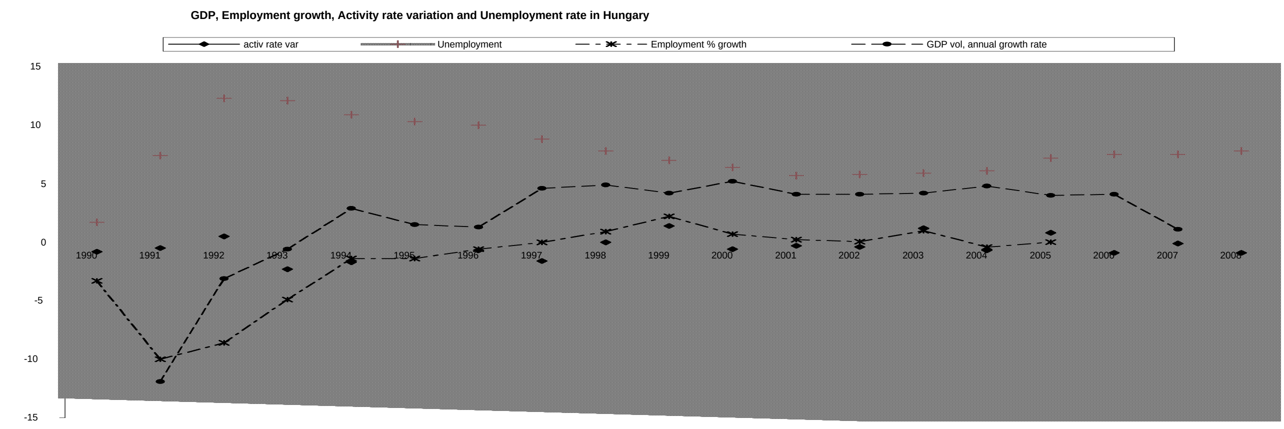


Figure 8

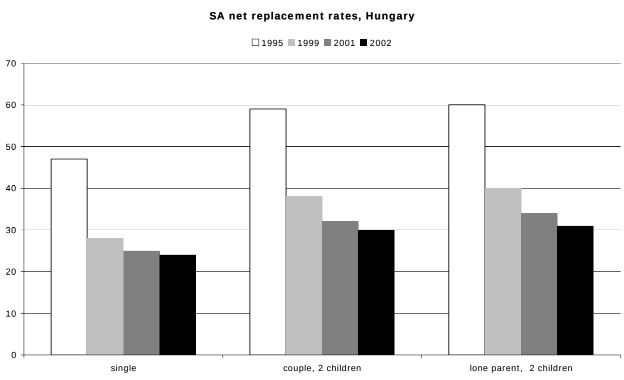


Figure 9

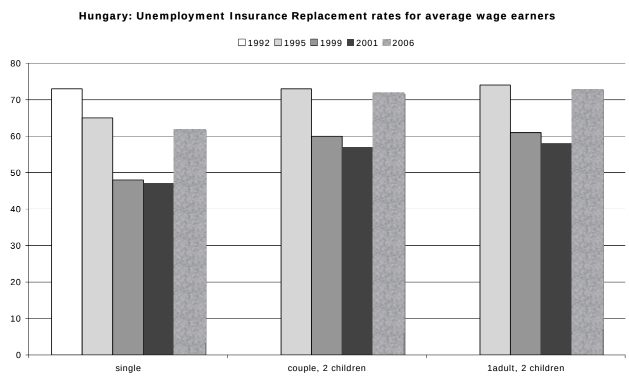


Figure 10

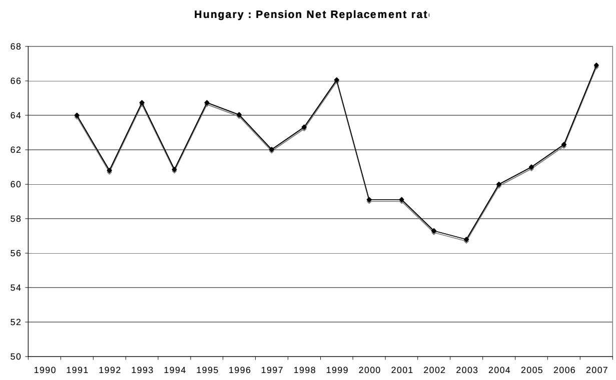
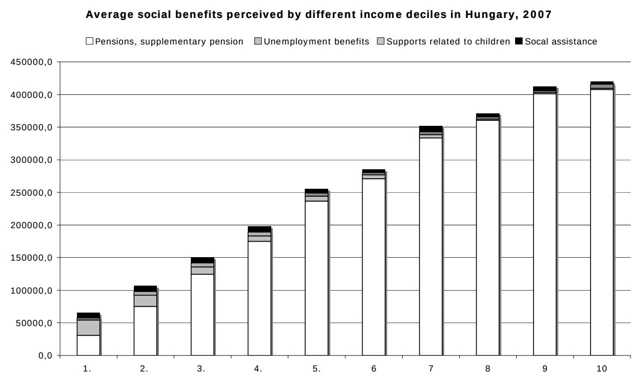


Figure 11



Sources: Figure 7: ILO and HSO (Hungarian Statistical Office); activity rate variation is calculated as percentage point variation. Figures 8 and 12: Hungarian Statistical Office; Figures 9 and 10: 1992 data is based on Adam [1999]; data for other years is from OECD Benefits and Wages, different years; Figure 11: 1991-92 data from Adam [1999]. From 1993: Own calculations, based on HSO.

Transformation crisis fuelled unemployment[11], while simultaneously decreasing activity rates[12] (Figure 1).

UI was introduced in 1989. It was paid up to 2 years at a declining proportion of average wages over the last 3 years[13]. UI benefits ranged from 80% to 300% of the minimum wage. UI was reformed repeatedly between 1991 and 1992. 1991 reforms increased social insurance[14] and augmented the minimum benefit (set at the same level as minimum wage). 1992 reforms increased social assistance vis-à-vis social insurance[15]. And the *big* 1993 reform reduced UI duration as well as social insurance element.[16] Social assistance elements were further enhanced, but their amount reduced.[17]

UI net replacement rate decreased consistently (Figure 9) and average real unemployment benefit dropped by 24% from 1992 to 1995 [Adam 1999]. Thus, emphasis shifted from protection to improving activity incentives. This, along with unemployment length increase[18], precipitated to UI coverage decline.

Old-age pensions were reformed importantly in 1992. The pension insurance fund was separated from the state budget. The traditional pension formula integrating the best three over the last five years was reformed to integrate the average wages from 1988. Ceteris paribus, by 2052 the DB formula should thus consider all the wage record. The emerging calculation method is a hybrid between DB (it is an employment-related formula) and DC (it considers all the wage history).

The reform enhanced individual relative to social insurance. This outcome was further enhanced by the introduction of private pensions. Voluntary pension funds were voted in 1993. This system involved important *de facto* transfers from the public budget, since half the contributions were deducted from income taxes.

Individual insurance elements were thought to reduce incentives to early retirement. These should translate into pension spending reduction, which was further promoted through transferring the responsibility for disability pensions to the Health insurance Fund.

[11] GDP decline accounts for 84% of unemployment rate variation from 1990 to 2008.
[12] Activity contraction increased disability pensioners, whose number boosted by over 241% from 1989 to 1990 [Adam, 1999]. The number of old-age pensioners increased by less dramatic 15% [calculations based on Adam 1999].
[13] 70% for 6 months, 60% for the next six months and 45% in the second year.
[14] In 1991, the reference period for benefit calculation was increased to 4 years and the proportion of the wages paid after 6 months were increased.
[15] Maximum UI benefit was established at 200% the minimum wage.
[16] In 1993, UI duration was reduced to 30 to 360 days (depending on the insurance period). UI benefits were set at 70% of average wages during the first three months, and reduced thereafter to 50%.
[17] Minimum and maximum ceilings were reduced and became independent of the minimum wage.
[18] While in 1992 only 12% of the unemployed were in that situation for over a year, this proportion increased to over 40% in 1996 [Adam 1999].

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In 1995 Finance Minister Bokros introduced more dramatic welfare reforms. This austerity package was inspired by Kornai's call for combining targeted assistance and private insurance [Ferge, 1998]. The overall aim of the Bokros reforms was to reduce social spending and to control demand-inflation. Public spending 3% decrease was achieved through non-indexation and benefit targeting.

Family allowances were reformed and became means-tested.[19] Nevertheless, some existing studies considered that universal family allowances were actually a cheap option to target child poverty [Ferge, 1998; Sibos and Ringold, 2005]. Bokros option to target these provisions was later backed by World Bank [1996]. Family allowance retrenchment explains replacement ratio decrease for families with children (Figures 8 and 9).

Generally, the Bokros package translated into slipping social assistance, unemployment and pensions net replacement rates (Figures 8, 9 and 10), in spite of real wage fall. These were aggravated by social assistance coverage problems.[20] These follow from discretionary administration at local level.

Pensions lost almost 30% in real terms from 1989 to 1996. Net replacement rates for old-age pensions oscillated (Figure 10) as a result of *ad-hoc* indexation. Pensions were further reformed in the second half of the 1990s. While disability provisions were switched back to the pension insurance fund, Disability provisions were also reformed and disability spending decreased relative to retirement (HSO).

Pension statutory age increased in 1996[21] and a major pension reform was launched in 1998. Hungary was the first post-communist country to introduce compulsory private pension accounts. The pension system is a three-pillar template in line with World Bank [1994] blueprint.[22]

The new pension system is hybrid in two senses. On the one hand, from 1992 reforms, it is a hybrid combining DB design (linking benefits to previous wages) and actuarial (DC) elements. On the other hand, the three pillar template combines a state-run hybrid system and private pensions. The emerging hybrid pension system enhanced individual over social insurance. It additionally developed social assistance elements (through a means-tested universal pension).

[19] Although the original design intended to exclude the top 20% of income distribution, the introduced package only excluded the top 10% [Sibos and Ringold, 2005].
[20] The World Bank [1996] Hungarian safety net study found a considerable proportion of the poor were excluded.
[21] Both men and women statutory ages were progressively raised from 60 and 55, respectively, to 62.
[22] The first pillar is an employment-related public system. The second pillar integrates compulsory individual pension accounts. The third pillar refers to voluntary accounts. There is also a zero-pillar, which concerns a specific safety net for persons after retirement statutory age.

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UI was also reformed in 1997, when the benefit formula was settled at 65% of individual average wages (over the last 4 years). The minimum unemployment benefit was set very low, at 90% of the minimum pension. Since the maximum unemployment benefit remains very low and UI is almost flat-rate for most workers. Indeed unemployment benefits were partly redistributive in 2007 (Figure 11).

The conservative government reverted means-tested family allowances into universal benefits. It also introduced tax breaks. Replacement ratios for couples with children and single parents are consistently higher vis-à-vis persons without children (Figures 8 and 9). Nevertheless, in general, replacement rates decreased.

As we can see in Figure 11, in spite of social assistance targeting, Hungarian social assistance benefits in 2007 were not concentrated in the lower income classes. As such, in spite of means-tests use, social provisions remain partially universal.

4. POLAND

Poland experienced a pronounced recession in the early 1990s but recovered rapidly from 1992. Ever since, growth rates have been generally high but job creation was limited, giving rise to both unemployment and inactivity.

Cumulatively, from 1990 to 2007, activity rates decreased over ten percentage points. Activity rate contraction was particularly pronounced in the 1990s and concerned three different processes: postponed entry of those under 24, [23] anticipated exit[24] and decreasing pensioner activity [25].

[23] This process was transitory, since inevitably they entered the labour market and inflated the number of the unemployed. Young workers experience unemployment rates around 30% in 1990-95 and even above 40% in the early 2000s (GUS – Poland Statistical Office).

[24] The number of pensioners increased by 22% between 1990 and 1996 [own calculations based on Adam 1999]; over the same period, the number of old-age pension recipients augmented by 29% [*idem*].

[25] From 1989 to 1990, the number of working pensioners decreased by almost 80% [*idem*].

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Figure 12

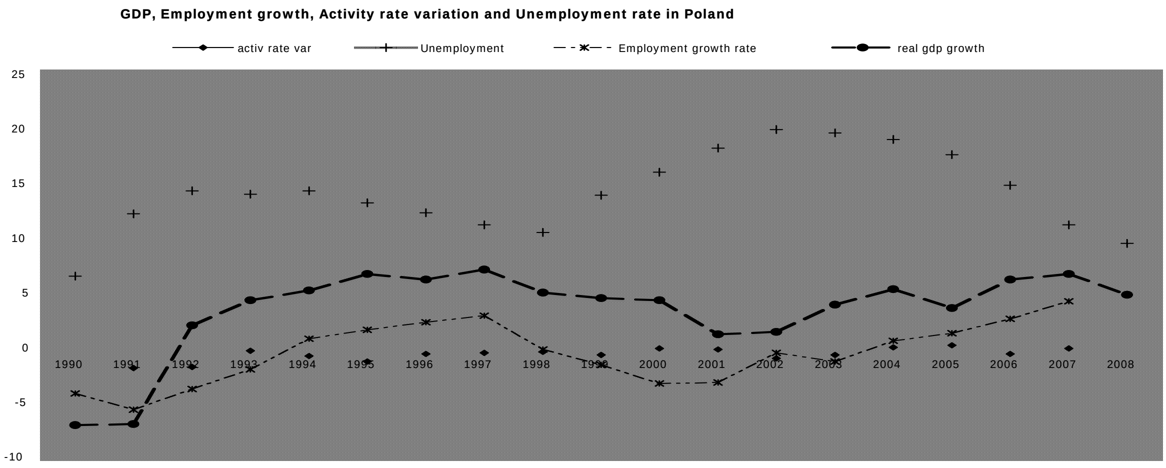


Figure 13

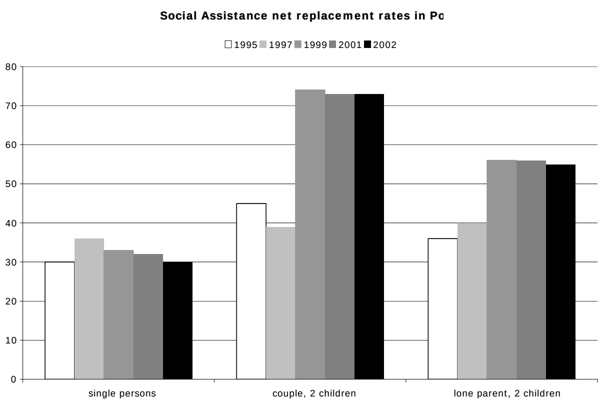


Figure 14 – UI net replacement rates, Poland

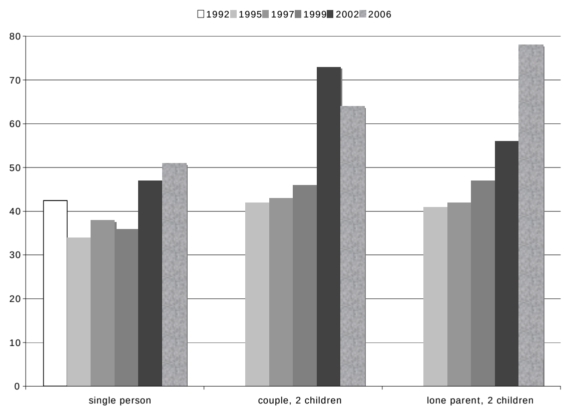


Figure 15

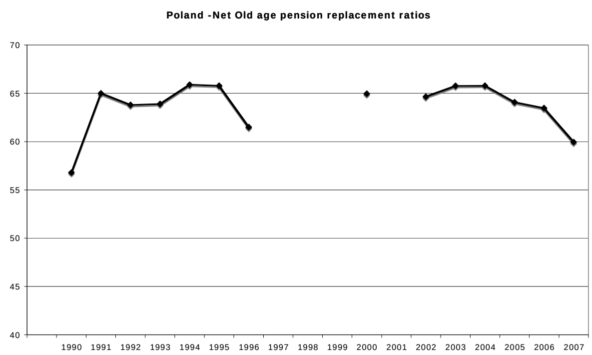
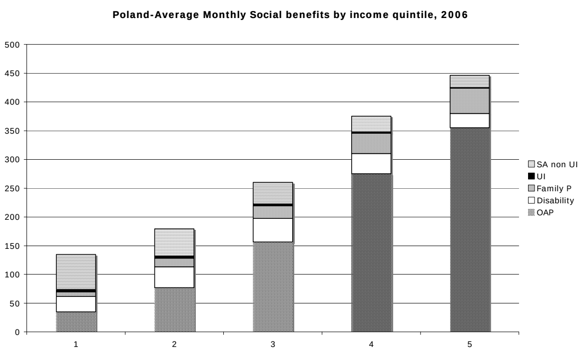


Figure 16



Sources: Figure 14: ILO and GUS; Figures 15 and 19: GUS; Figures 16 and 17: 1992 data is based on Adam [1999]; data for other years is from OECD Benefits and Wages, different years; Figure 18: 1991-92 data from Adam [1999]. From 1993: Own calculations, based on GUS.

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An universal, unlimited and employment-related UI was introduced in 1989; it paid up to 70% of preceding wages during the first three months (then 60% for six months and 45% afterwards). Minimum benefit was at minimum wage level.

The 1992 reform rapidly reduced UI duration to 12 months. UI became a flat-rate means-tested benefit.[26] The social insurance elements were reduced to: (i) entitlement required a minimum one-year contribution record; and (ii) up to 2001, in the case of collective lay-offs UI paid 75% of previous wages.

Consistently, unemployment benefit net replacement ratios decreased in the first half of the 1990s (Figure 14) and the average unemployment benefit decreased by 8% in real terms from 1992 to 1995 [Adam 1999]. The actual situation of the unemployed was aggravated by low coverage. In 1992-96, although those unemployed for more than a year have represented 40 to 55% of the unemployed were not covered [GUS]. Although UI duration was increased in 1997 for those with a long contribution record, only 15% of the unemployed received UI in 2003 [GUS].

As in other countries, limited duration with growing long-term unemployment leaves a considerable part of the unemployed to social assistance. Social assistance is mean-tested (for income and land) but the benefits are lower then UI and administered discretionarily by local authorities.

Social assistance net replacement ratios generally decreased (Figure 13). The situation is worse than in the other countries since poverty rates are higher in Poland and increased dramatically in the early 1990s.[27]

Unemployment and social assistance benefit replacement ratios were only slightly superior for people with children. Social assistance replacement rates penalised lone parents relative to couples with children. This probably reflects the hazards of discretionary social assistance.

Pensions were reformed significantly. In the early 1990s, the different systems were unified, except for the farmer system. The farmer pension system is actually highly subsidised and covers only about 8% of its yearly pension spending.

Although pension replacement ratios increased in the first half of the 1990s (Figure 15), average pensions decreased in real terms until 1994. Given the pressure of pensioner increase on spending, pensions were reformed again in 1999. The emerging pension system is depicted in Table 2.

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[26] Means-tests included other income as well as agricultural property (which cannot exceed 2 ha).
[27] These increased from 17% in 1989 to over 34% in 1991 [Sibos, 1994].

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Table 2- Different pension systems in Poland.

<table>
<tr><th>Born:</th><th>Public</th><th>Obligatory private</th><th>Voluntary private</th></tr>
<tr><td>Up to 1949</td><td>DB</td><td>No</td><td rowspan="3">Voluntary</td></tr>
<tr><td>1950 to 1969</td><td rowspan="2">NDC</td><td>Option < 2000</td></tr>
<tr><td>From 1970</td><td>Compulsory</td></tr>
</table>

Those born before January 1st, 1950 will receive DB pensions, combining an employment–related features (contributing years) and a safety net to those having contributed a minimum number of years (basic pension). This system thus combines social insurance and a limited social assistance component.

Those born afterwards were included in a new system. At retirement, the total amount of contributions made is converted into a stream of monthly pension payments using the average life expectancy. This NDC (notionally defined contribution) pension system is hybrid because it replicates individual insurance. Here, redistribution disappeared and protection is limited to social assistance.

The individual insurance element was further enhanced by private pension accounts. These were compulsory for those born after January 1st, 1970. Those born between 1950 and 1969 could opt for this system until the end of 1999. This choice was irreversible.

While pension reformers sustained the pension balance would turn positive from 2013, present projections expect the system will run a deficit until 2050. This is a result of the costs of transition. As in Hungary, the public system has to share payroll contributions with private funds, its financial situation deteriorates with the shift towards a partially funded system. Pensions replacement rates should decrease further and will support weight of budgetary needs (Figure 15).

In spite of pension reforms, workers still retire on average before entitlement. Still, the average retirement age has increased from 56,6 in 2001 to 59,5 in 2005 [Eurostat]. Consistently the proportion of old-age pensioners under 60 was reduced from 21% in 2005 to 18% in 2007. Nevertheless, pre-retirement benefits are above unemployment benefits. Additionally, disability pensions new entitlements have decreased from 2000 and disability spending contracted importantly.

Data for income sources of 2006 income quintiles (Figure 16) reveals that while pensions (old-age and disability) are not redistributive, unemployment insurance and social assistance are relatively redistributive. This can be explained by the UI calculation formula, where social insurance was weakened vis-à-vis social insurance.

5. WELFARE STATE PARADIGM SHIFTS

A. *Defining paradigms and shifts*

In Kuhn's scientific revolution analysis, a *paradigm* defines: (i) pertinent variables; (ii) suitable questions and how they are structured; and (iii) valid outcome interpretations. These criteria will allow a specific set of theories to maintain their scientific authority.

Since every paradigms leaves some topics unaddressed (defined as anomalies), their accumulation can lead to a crisis. The crisis will only be followed by a paradigm change if there is an alternative and coherent competing set of theories fulfilling the criteria set above.

In social sciences, a *paradigm* typically means a *worldview*, shared commonly by society members. This is close to what Veblen called the *dominant habits of thought*. These, in turn, limit legitimate problems and define the reasonable interventions.

We consider a *welfare state paradigm* delimits (a) background *dominant habits of thought* supporting the welfare state; (b) relevant interactions between variables; and (c) the emerging social protection mix, combining social assistance as well as social and individual insurance. These elements tend to create a loop, because they legitimise status quo.

Institutionalism clearly states that evolution is mainly cumulative and path dependent. This principle was applied to welfare state evolution [Beyeler, 2003; Myles and Pierson, 2001]. Indeed, welfare states are path dependent in two senses.

First, welfare provisions cannot be reconstructed overnight. They are complex systems of entitlements, which are not always interrupted by reforms. Pension reform in Poland in table 2 shows reforms are introduced as additional layers of an increasingly pension system.

Second, the existing welfare provisions influence the costs of alternative reform options. Path dependence means path-breaking reforms will be costly. This was the case of partial pension provision privatisation in Hungary and Poland. In these countries, setting compulsory pension accounts diverted contributions away from the state system, therefore aggravating its financial stance.

How can costly reform alternatives be pursued? There are two major ingredients. One is how the costs of alternative options are evaluated. The second is that alternative worldviews establish a welfare state crisis and the need, indeed the imperative of shifting. Experts are essential in the process of cost and advantage evaluation.

Indeed, paradoxically, in spite of the significant cost involved, partial privatisation in Hungary and Poland was presented as a way to promote pension sustainability. This was because it was presented as the only alternative to a state pension catastrophe in the non-reform scenario.

An interesting implication of path dependence is that path-breaking changes will also have increasing returns. This will favour de development of complementary institutions. They will, in turn, influence the evolution of dominant *habits of thought*.

B. *Dominant habits of thought*

At any moment in time, there are different and even antagonist *habits of thought* affiliated to different groups. Antagonism developed with post-socialist transformation, as different groups tried to put forward their values and beliefs. Eventually some *habits of thought* become dominant and are institutionalised in legal settings.

Welfare state recalibration was influenced by ideas about the role of the state in a market economy. In the early years, governments where concerned with the *social costs of transition* (to quote Adam, 1999). They introduced social assistance and they reformed financial schemes.

Very rapidly more conservative *world views* became dominant. This was the case of Klaus's plea for *a market without adjectives*. Furthermore, a consensus developed over Kornai's idea that these countries were premature welfare states, because they spent more on social provisions than Asian countries with a similar average income. These influenced the bargaining over antagonist welfare state paradigms.

Vecernik [2007] highlights there were competing views on welfare state and how it should be reformed in Czech Republic. While the public was oriented towards Social Democratic values, ODS governments preferred a more *residual* welfare state. In this case, legislative power allowed for the institutionalisation of a specific worldview. This allowed to restrict UI and promote private pensions.

Müller [1999] presents the different beliefs of the different actors involved in pension reforms in the three countries (Ministry of Finance, Ministry of Social Affairs, Social partners). These different actors used negotiations to put forward their respective propositions on pension reform. In Hungary and Poland, the Ministry of Finance proposition for partial privatisation gained weight because the World Bank backed it.

These examples show dominant *habits of thought* influence the dynamics of different welfare provisions. This, in turn, will influence the emerging welfare mix. This is influenced by what cause-and-effect relations are put forth by epistemic communities.

C. *Relevant interactions between variables*

Epistemic communities are a "*network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area*" [Haas, 1992]. These experts share a set of normative and causal beliefs, on which they base their advice.

In the case of CEE, there was a key epistemic community related particularly to international financial institutions, such as the World Bank and the IMF [Deacon 1997; Stubbs, 2003]. The World Bank was particularly influent in promoting the introduction of three pillar pensions, involving partial privatisation [Müller, 2003].

These epistemic communities establish the link between welfare state paradigm and mainstream economics. Typically mainstream economics analysis of welfare state is based on the hypothesis that state intervention is acceptable in the case of market failure. Nevertheless there may be controversies over market failures and state failures. These influence what social protection instruments are perceived as legitimate.

Post-WWII OECD welfare states were based on a demand-side framework, where the involuntarily unemployed were protected by social insurance. UI was de facto an ex-ante safety net and social assistance was concerned with residual social exclusion. Private and public pension schemes developed simultaneous and complementary [Matos, 2009].

Supply-side economics is a major influence of welfare state recalibration [Aust and Arriba, 2005; Taylor-Gooby, 2004]. This approach considers unemployment is determined in the labour market and highlights social benefits depress labour supply because of the leisure preference. UI and SA should thus be limited if they are to foster activity rates. Conversely, individual insurance, because it is based on actuarial elements, should keep activity rates high.

Replacement rate evolution gives an interesting insight on the balance between insurance / protection and incentives matters. Where incentives concerns prevail, replacements will be limited and entitlements restricted. This, in turn, weakens social insurance and protection.

Concerns about incentives dominated international agencies' publications on Central European welfare states. In 1994 and in 2005, the World Bank edited two volumes putting

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together its consultants' ideas on labour markets and social policies. Contributions repeatedly refer the problem of incentives.

Declining benefit net replacement rates in the three countries were in line with such concerns. While benefit replacement rates are considerably better for people with children, it is clear that it is child-related provisions that are actually protecting.

Dominant habits of thought on interactions between economic variables influenced, in turn, the emerging social protection mix, combining social assistance, social insurance and individual insurance.

D. *The emerging social protection mix*

1. Promoting individual relative to social insurance

Pension reforms were a major ingredient in welfare state recalibration. The emerging systems are presented in table 4. They combine different sub-systems.

Table 4 – Confronting the old-age pension systems

<table>
<tr><td></td><td>Czech Republic</td><td>Hungary</td><td>Poland</td></tr>
<tr><td>Public</td><td colspan="2">Safety net + Employment related
Hybrid DB and DC</td><td>Safety net
DB/NDC</td></tr>
<tr><td>Private compulsory</td><td>No</td><td colspan="2">Yes</td></tr>
<tr><td>Voluntary private</td><td colspan="3">Yes</td></tr>
</table>

All countries reformed the public pensions pillar in order to increase the relationship between contributions and pensions. We have seen in the individual sections, these reforms led to the emergence of hybrid templates, combining social and individual insurance.

The individual insurance element is further enhanced by private accounts. All three countries have voluntary private pensions. Hungary and Poland also introduced compulsory private pensions.

Pension recalibration reflects state disengagement and an increase in private insurance. The growing pension individualisation means an increased the proportion of risks supported by the individual. Redistribution was consistently limited to a residual safety net.

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Furthermore, private pension design as individual private accounts left out occupational pensions, which are dominant in most EU countries [Matos, 2009]. This reflects an option to abandon occupational-based benefits, which were dominant under central-planning. More recently, there has been some progress in occupational pensions, particularly in Poland.

State pensions became an adjustment variable. They are manipulated to limit spending, which rose particularly in countries which partially privatised pensions provisions. They are also restricted as an incentive to take-up private pension accounts.

2. Enhancing social assistance vis-à-vis social insurance

Some major trends in welfare state reforms in the three countries show that reconciling work and protection was articulated around the leisure trade-off. There is a clear concern about increasing activity and employment rates. This influenced pension reforms (DCs and hybrid DBs are thought to fuel incentives to work longer), disability reforms, UI and SA reforms.

Poland adopted a flat-rate <u>UI</u>, which further compresses the social insurance factor. Work history only affects entitlement duration (from 6 to 18 months). In the other two countries, the maximum UI is so low that employment-related UI is *de facto* flat-rate for most wage-earners.

UI duration cuts in spite of an increasing unemployment length entailed a decreasing coverage and left long term unemployed to social assistance. It consistently weakened social insurance relative to social assistance. This evolution was particularly visible in Czech Republic, where UI benefit entitlement is the shortest. UI retrenchment was also swift and noticeable in Hungary and Poland.

Conceived to promote re-employment and to limit social spending, these reforms have sacrificed social insurance.

Unlike UI, <u>SA</u> is administered locally and does not guarantee horizontal equity. Discretionary and low social assistance is a prevalent legacy from the central planning. While systematic SA was introduced, there is still some discretionary assistance.

SA benefit design influenced simultaneously by incentives and spending concerns. Like UI, SA net replacement rates are importantly increased by family assistance and allowances.

There was some discussion among experts about the interest of targeting family benefits. Since poverty is correlated to family size some authors have sustained family allowances are de facto automatically targeted [Sibos, 1994; Ferge, 1998]. The World Bank

[1996] study on Hungary 1993-1994 objected to that perspective. While Hungary did target family allowances, means-testing proved expensive and unpopular and was eventually removed.

Provisions introduced after 1989 are generally targeted. Their residualist character was not questioned, in spite of the costs of and the problems with administering means-tests. On the contrary, the SA approach actually has occupied a part of the social insurance (as with UI).

Disability pension reforms were also dominated by the need to promote activity. Increasing the employment of disabled persons is also a concern throughout the EU and is at the heart of the equal opportunities topic. This subject was largely neglected under central planning.

Up to now reforms have been dominated by negative action, like cutting back pensions. While this may force some back to the labour market, not all those earning a disability pension are cheating. Worse: work security was neglected under central planning and remains a subject of concern.

Disabled persons will need measures such as employer incentives and training. Otherwise, disability pension cuts will simply shift disabled persons to social assistance. Again, these reforms shift social insurance to social assistance.

To conclude, incentives and spending concerns dominated social insurance and SA reforms. There was generally an increase in the assistance dimension relative to insurance. This was particularly salient in unemployment insurance.

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CONCLUDING REMARKS

Czech Republic, Hungary and Poland reformed their social policies differently. In spite of the differences, there are some common ingredients. We interpreted these common trends as welfare state paradigm shifts.

We witness a general contraction of social insurance relative to both private insurance and social assistance. These transformations can partly be related to international welfare recalibration trend and to shifts in mainstream economics.

These reforms abridged the role of the state both quantitatively and qualitatively. Quantitatively, benefit replacement rates were cut and entitlement limited. Qualitatively, social insurance lost weight and redistribution was limited to the social safety net.

Individual responsibility is at the core of new provisions. Namely, individuals should partly provide for their own old-age income. Furthermore, the preeminence of incentives problems reveals that the notion of voluntary unemployment gained foot.

While reforms were justified in terms of fiscal problems, they entailed considerable costs. Particularly, pension partial privatisation entailed transition costs. This has high opportunity costs in terms of other public spending.

Furthermore, private pension returns have been noticeably curtailed by the present crisis. In this situation, the state will be called forth to assume different responsibilities in terms of pension fund regulation.

At a moment when the field of state intervention is evolving and even bank nationalisations have been considered legitimate in some countries, one can only wonder how these changes will affect the welfare state paradigm. Particularly, will some pension funds be nationalised?

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ISCTE-IUL – Av. das Forças Armadas, 1649-026 Lisboa, PORTUGAL
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