

World Bank Policy Research Working Paper

**How Politics and Institutions Affect Pension Reform
in Three Postcommunist Countries**

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The findings, interpretations, conclusions, and all errors in this paper are those of the author and should not be attributed to the World Bank.

ABSTRACT

Orenstein examines the political and institutional processes that produced fundamental pension reform in three postcommunist countries: Hungary, Kazakhstan, and Poland. He tests various hypotheses about the relationship between deliberative process and outcomes through detailed case studies of pension reform.

The outcomes of reform were similar: each country implemented a mandatory funded pension system as part of reform, but the extent and configuration of changes differed greatly.

Countries with more "veto actors" -- social and institutional actors with an effective veto over reform -- engaged in less radical reform, as theory predicted. Poland and Hungary generated less radical change than Kazakhstan, partly because they have more representative political systems, to which more associations, interest groups, and "proposal actors" have access. Proposal actors shape the reform agenda and influence the positions of key veto actors. Pension reform takes longer in countries with more veto and proposal actors, such as Poland and Hungary. Legacies of policy, the development of civil society, and international organizations also profoundly affect the shape and progress of reform.

Orenstein sees pension reform as happening in three phases: commitment-building, coalition-building, and implementation. He presents hypotheses about tradeoffs among inclusiveness (of process), radicalism (of reform), and participation in, and compliance with, the new system.

One hypothesis: Including more, and more various, veto and proposal actors early in the deliberative process increases buy-in and compliance when reform is implemented, but at the expense of faster and greater change.

Early challenges in implementation in all three countries, but especially in Kazakhstan, suggest the importance of improving buy-in through inclusive deliberative processes, where possible.

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1 INTRODUCTION*

This paper derives and tests a set of hypotheses about the influence of political-institutional structures and processes on pension reform in the postcommunist states. In particular, the report seeks to understand the ways that political-institutional variables have shaped pension reforms in Kazakhstan, Hungary and Poland. These were the first three postcommunist countries to adopt multi-pillar pension reforms including a funded, private pillar, with advice and assistance from the World Bank. However, the size and structure of this funded pillar, as well as numerous other aspects of its regulation, and the character of simultaneous changes in other pillars of the pension system, differ greatly across the three countries. What are the main differences and why did they occur? What impact have political processes and institutional structures had on the outcomes of reform? In answering these questions, this report aims to draw lessons for future World Bank involvement in national social policy processes.

The type of pension reform implemented in Kazakhstan, Hungary and Poland -- what I will call "fundamental" (Rutkowski 1998) or "multi-pillar" reform -- goes beyond making significant changes to the parameters and structure of the pre-existing state system. It is characterized by the partial replacement of the former state system with a mandatory pension system, in which individuals save for retirement through defined contributions to special pension accounts. Pension funds invest these contributions on individuals' behalf and at the end of his or her working life, the contributions and investment returns, minus fees, are used to purchase an annuity that provides the individual with retirement income. This type of system is called a "funded" system, because pensions are backed by actually-existing money, on deposit with a pension fund. Such pension privatization represents a "paradigmatic shift" from the Bismarckian and Beveridgean models of old-age security that have dominated in Europe for over a century (Muller 1999). It is part of a global trend towards creating "private markets for public goods" (Graham 1998). Multi-pillar pension reform is, however, distinct from the Chilean model. Chile adopted a pension system that relies almost entirely on a private, funded pillar, with a modest minimum pension guarantee. While the multi-pillar model advocated by many at the World Bank (1994) often includes a private funded pillar, as in Chile, it does not seek to eliminate public pay-as-you-go systems entirely, nor does it recommend sole reliance on private, funded systems.

As in Western Europe and Latin America, state-run pay-as-you-go (PAYG) pension systems have predominated in postcommunist Europe since the second world war. A PAYG system is one in which current tax revenues finance current benefits. Such a system is based on an intergenerational pact in which today's workers support today's pensioners, and in turn are promised support in their old age by a future generation of workers. The state establishes, maintains and administers this social contract. PAYG pension systems have served the first generations of participants well, but now face a number of problems, particularly population aging, that have called into question the future of PAYG systems in countries around the world (World Bank 1994). In postcommunist Europe, PAYG systems also suffered a series of shocks in the 1990s, related to market transition. Economic downturn caused

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contribution rates to PAYG systems to drop as unemployment and "gray" market economic activity increased. At the same time, postcommunist pension systems were often used to alleviate labor market adjustment, by moving older workers into early retirement (Cangiano et al. 1998; Andrews and Rashid 1996). This led to the growth of a large implicit public pension debt that threatens to make current systems unsustainable (James 1998a, 274). In postcommunist countries, the system dependency ratio, the number of pension beneficiaries to the number of contributors, has risen sharply during the transition (Cangiano et al. 1998, 10; Andrews and Rashid 1996).

Governments have attempted to adjust in a number of ways. In some countries (Poland, Latvia, Bulgaria, Slovakia), governments raised taxes to finance increased pension expenditures. In other countries (Hungary, Czech Republic, Croatia), governments controlled spending by cutting benefit levels, in a systematic or ad hoc manner. Still other countries (Kazakhstan, Romania, Russia) contained pension spending through the accumulation of sizeable payment arrears (Cangiano et al. 1998; Andrews and Rashid 1996).

TABLE 1. PENSION SYSTEM DEVELOPMENTS, 1990-1996

	Pension expenditure/GDP	Number of Pensions	Average Pension in real terms	Pension revenues/GDP	Number of contributors	Contribution rate	PAYG financial balance
Kazakhstan	Broadly constant at about 4.5%, but large arrears, up to about 2% of GDP at end-1996	Increasing in early 1990s, then declining, reflecting demographic factors and emigration	Increasing as a percentage of GDP	Declining	Declining	Declining since 1993	Broadly balanced, except for arrears
Hungary	Broadly constant (at about 10% of GDP)	Rising rapidly (20 percent during 1989-95), reflecting sharp increase in disability pensions, but also early retirement	Sharp drop in real terms (25% from 1990-95) due to less than full price indexat'n, and fall in real value of entry pension	Dropping rapidly because of base erosion, in the presence of high contribution rates	Declining	Broadly constant at very high levels (35%), declining in 1997	PAYG balance deficit deteriorating by about 2% of GDP between 1991-95
Poland	Pension expenditure ratio doubled in early 1990s, to about 15%; approximately constant since then	Increased rapidly as a result of early retirement and disability pensions in early 1990s	Generous pension increases in the early 1990s, more contained real growth after 1991; decreasing since 1996	Rising in the early 1990s, although not as much as expenditure, broadly constant since then	Declining	Increase in the early 1990s; broadly stable since then	Sharp deterioration in the early 1990s with budget subsidies rising to 6% of GDP in 1992; cut to 0.5% by 1996 plus 2% for farmers system

Source: Adapted from Cangiano et al. (1998, 12).

Table 1 shows that Kazakhstan, Hungary, and Poland faced very different pension system problems in 1996. Pension expenditure as a percent of GDP ranged from under 5% in Kazakhstan, to 10% in Hungary, to 15% in Poland. Much of this difference can be explained by strategies of adaptation after 1990. In Kazakhstan, pension expenditures were controlled through the buildup of substantial pension arrears, amounting to about 2% of GDP at the end of 1996. In Hungary, pension expenditures were controlled at pre-transition levels by less-than-full price indexation of benefits, while system dependency grew dramatically. In Poland, eased eligibility criteria for pensions and increased benefit levels in the early 1990s caused pension expenditures to double as a percent of GDP. It is worth noting that Poland has one of the highest levels of pension expenditure in postcommunist Europe, despite having a relatively young demographic profile, especially compared to Hungary. The ratio of people aged 60 and up as a percentage of those 20-59 years old was 29.9% in Poland, compared to 35.6% in Hungary in 1996 (Schrooten et al. 1998, 6-7). The only common feature of the pension crises in all these three countries was the drop in compliance rates. However, in their different ways, each of these countries' pension systems experienced severe financial strains. After trying a variety of strategies to adjust to the new burdens placed on their pension systems, the three countries examined in this report all opted for fundamental reform.

The World Bank has been recommending to countries around the world that they enact fundamental pension reform in which "some of an individual's pension is financed by preretirement savings, which are privately managed" (James 1998a, 275). The model advocated in The World Bank's Averting the Old Age Crisis (1994) contains three pillars, that may be weighted and configured in various ways:

1. A mandatory, publicly managed, tax-financed first pillar for pension redistribution
2. A mandatory, privately managed, fully funded second pillar for savings
3. A voluntary third pillar for people who want more protection in their old age.

The first pillar, in this view, should be more redistributive than most current PAYG plans, and be geared towards achieving the Beveridgean goal of basic income support. This can be achieved through a flat benefit (as in Argentina or the United Kingdom), a means-tested benefit (as in Australia), or a minimum pension guarantee (as in Chile). Because of their mainly redistributive function, they can be financed, in part, from general tax revenues. The second pillar provides a means of pension savings, in the form of a state-mandated, privately-managed system. Pension benefits in this pillar are fully-funded. Contributions are defined, but the level of benefits depends on the outcome of investment decisions. The World Bank assumes that funded pillars will be more sustainable than pay-as-you-go systems and competitive private management will lead to better returns than public management. A voluntary third pillar can be organized in a number of ways, for instance as enterprise- or industry-based funds, mutual-benefit societies or private insurance, and offers supplemental benefits.

Countries around the world -- mostly in Europe and Latin America -- have implemented multi-pillar systems. And many postcommunist countries are considering implementing them in the future. Existing multi-pillar systems have been implemented both with and without World Bank assistance, and they have differed along several dimensions. Perhaps the key dimension of difference is the relative size of the private and public pillars. For example, in Latin America, Chile phased out its public pay-as-you-

go system, Uruguay chose a large public pillar, and Argentina fell somewhere in between. But there are other important differences. One concerns whether the employer or employee chooses where to invest the funds. Australia, for instance, built its mandatory, funded pillar on top of a voluntary system of occupational (employer) pensions that already covered 40 percent of the population in 1986. Hence employers choose where to invest (World Bank 1994, 274) (although increasingly workers are being given some choice here). However, many other countries base their systems on individual choice among competing pension investment funds. Another important design difference concerns whether, and for whom, the funded system is mandatory. In Peru, private funded and pay-as-you-go public systems coexist, and workers can choose to participate in one or the other. In many other countries, however, all or some categories of workers must participate in the funded system. Finally, some reforms concern mainly the first pillar. Sweden and Italy, for instance, both switched to defined-contribution first pillars that remain largely pay-as-you-go (James 1998a, 278).

In the postcommunist countries, similar variation can be observed. Kazakhstan is phasing out its PAYG first pillar and replacing it with a minimum pension guarantee, while Hungary or Poland both decided to maintain large, earnings-related first pillars. However, they are doing this in different ways. Hungary is rationalizing its defined benefit first pillar, while Poland chose to introduce a “notional defined contribution” system with individual accounts (described below). Kazakhstan will have a much larger private to public ratio than either Hungary or Poland, and all three countries chose different ways of organizing and regulating their new private pillars. How did policy legacies and institutional structures influence the design of fundamental pension reforms? What influence did particular interest groups have? And how have differences in the political process in each country shaped outcomes?

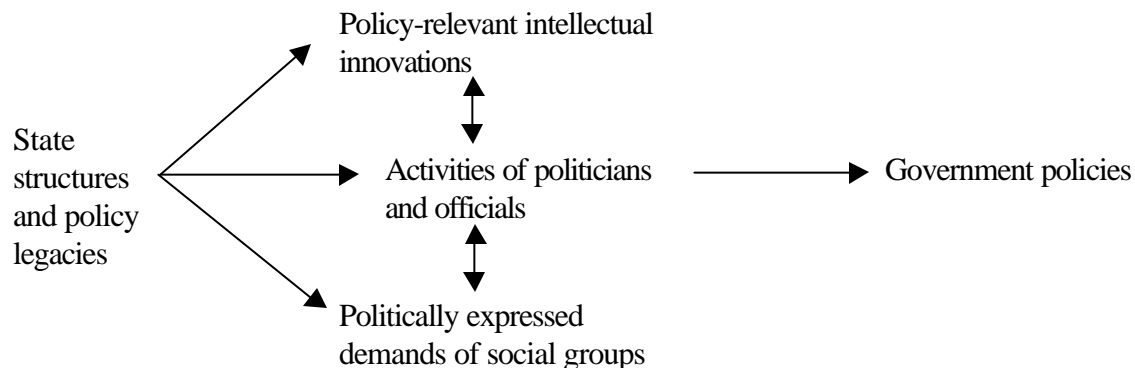
The following three sections develop a general model of the social sector reform process and use it to derive testable hypotheses about the role of policy legacies, political-institutional factors and international influence in fundamental pension reform. These hypotheses are tested through comparative case studies of the policy process in Kazakhstan, Hungary and Poland in section five. Section six derives comparisons and some general lessons about the impact of the major actors in postcommunist pension reform. Section seven presents policy recommendations based on the case study findings.

2 THE POLICY PROCESS FOR SOCIAL SECTOR REFORMS

2.1 POLICY LEGACIES

In Bringing the State Back In, a path-breaking 1985 book that heralded the rise of a “new institutionalism” in the social sciences, Margaret Weir and Theda Skocpol presented a model of social sector policy change. Elaborated to explain the different ways in which states embraced or did not embrace Keynesian policies in the 1930s, the model showed how state structures and policy legacies shaped the adoption of economic reforms.

FIGURE 1. A MODEL OF INSTITUTIONAL INFLUENCES ON THE POLICY PROCESS



Source: Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesianism': Responses to the Great Depression in Sweden, Britain, and the United States," in *Bringing the State Back In*, eds., Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, Cambridge: Cambridge University Press, 1985, 119.

While previous models had emphasized the demands of social groups or new ideas (intellectual innovations) as being at the root of the switch to Keynesian policies in the 1930s, Weir and Skocpol demonstrated that these factors by themselves could not explain important variations in the ways that Britain, Sweden, and the United States implemented Keynesian policies. Their analysis showed that the content of radical policy change is heavily influenced by previous state structures and policy legacies. Weir and Skocpol found that pre-existing policy biases, institutions and programs determined the specific forms that Keynesianism took in each country.

The finding that institutional structures and policy legacies have a strong impact on the direction of change will not surprise anyone with experience of social sector reform in the postcommunist countries. Studies have shown that institutional legacies of the communist welfare state regime are the most important factors influencing social policy during the post-1989 transition (Ringold 1999), including high social spending. Policy legacies of the early transition period are also crucial (Cain and Surdej 1999). Decisions and non-decisions taken during this time constrain the choices of policymakers considering fundamental reform.

Weir and Skocpol showed that government social policies are the outcome of a complex, path-dependent process whereby politicians, usually situated in positions determined by the institutional configuration of the old system, respond to ideas generated or interpreted through the mechanisms of the old system, and respond to social groups whose interests and expectations are also influenced by, and expressed through the old system. Given the heavy weight of existing state structures and policy legacies, even the most radical reforms tend to run through the channels cut by previous state policy.

This model suggests the hypothesis that policy legacies influence the design of social sector reforms. One of the key policy legacies in the area of pension reform is the size of the pension system, and particularly the size of the implicit pension debt (IPD), "the present value of the pension promises

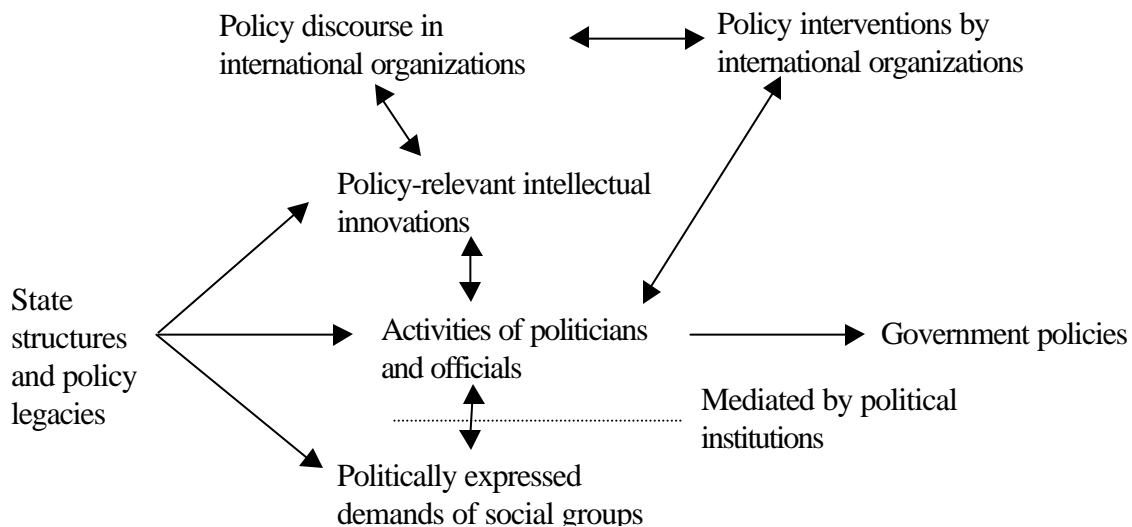
that are owed to current pensioners and workers because of their participation in the old system" (James 1998b, 459). Based on previous research (James 1998b), we would expect countries with high implicit pension debt, and therefore a higher cost of financing the transition to a private, funded system, to choose a lower private share and a larger public pillar. As James writes, "The larger the implicit pension debt (IPD). . . . the greater the likelihood that this method will be used. Most countries that ended up with a large, hence earnings-related, public pillar had a high IPD in the old system " (James 1998b). We would also expect other aspects of pension reform to reflect continuities with previous policy designs and institutions. Thus hypothesis 1 predicts:

H1: Policy legacies influence present reform choices. In particular,

- *Countries with higher implicit pension debt will choose a smaller private pillar and retain a larger PAYG public pillar, in other words, less radical reform.*
- *Other pension reform design elements will build upon the legacies of pre-existing pension institutions.*

Although Weir and Skocpol's model offers a useful way to analyze the influence of political institutional variables on economic reforms in a domestic context, it also leaves some important elements out. In particular, the recent spread of pension reforms internationally raises the need to include the mediating role of political institutions and the influence of international organizations in the model. Figure 2 presents a modified model of the social policy process, building upon the Weir and Skocpol's emphasis on policy legacies. These changes are discussed in the following sections on mediating political institutions and the influence of international actors.

FIGURE 2. MODIFIED MODEL OF THE SOCIAL POLICY PROCESS



2.2 POLITICAL INSTITUTIONS AND POLICY ACTORS

Political institutions have a great deal of influence in determining which actors are most influential in a given policy area. They not only define who the relevant policymakers are, but also strongly shape opportunities for effective interest group mobilization. Different institutions structure the policy process and mediate relations among policy actors in different ways. They render policy-makers more or less insulated from some interest groups and parties, and more or less responsive to some others. But which political institutions are the most important in shaping and mediating the policy process? Political institutions can be divided into numerous categories, including authoritarian versus democratic systems, presidential versus parliamentary systems, majoritarian versus consensus democracies, etc. One recent effort to move beyond these overlapping dichotomies suggests that systematic effects of political institutions on policy can best be studied by looking at the number of "veto players" or "veto actors" involved in a particular policy area under particular institutional arrangements (Tsebelis 1995). The approach taken here builds on Tsebelis' framework for understanding how institutions structure the possibilities of policy change.

Veto actors. According to Tsebelis, veto players can be divided into three groups: institutional veto players, who have a constitutional right to exercise veto power over legislation; partisan veto players, who have the effective power to veto legislation by virtue of their position as part of a majority in parliament or a governing coalition; and other veto actors, who may vary by policy area within one country or even one government, but may include interest groups that are strong enough or mobilized enough to effectively veto policy in a particular area. In Tsebelis' system of counting, veto players with identical policy positions are counted as one actor. Tsebelis develops the hypothesis that: *The greater the number of veto players, and the greater the distance between their policy positions, the more policy stability (and less change) there is likely to be* (Tsebelis 1995, 293).

For the purposes of this study, where our concern is with explaining the nature of radical policy change in pension systems, it is useful to formulate the corollary to this principle:

H2 (preliminary): *The fewer the number of veto actors and the less distance between them, the greater the opportunity for change in the scope and size of the PAYG pension system.*

Proposal actors. One limitation of Tsebelis' framework is that veto actors are often not the only actors making proposals for reform. Indeed, veto actors may not have strong or fixed policy preferences. In some cases, veto actors do not reveal policy preferences until late in the process, and in others they change positions over time as a result of side-payments or deliberation and the consideration of alternative proposals.

Building on Tsebelis' framework, I therefore define and examine the importance of "proposal actors" in addition to "veto actors" in the policy process. Proposal actors often have a separate and independent influence on reform, acting as intellectual agenda-setters for reform. In complex policy areas, where veto actors do not have the relevant expertise to develop their own concrete policy positions, they may rely on proposal actors to determine policy preferences for them, or to set the general terms of debate and the range of policy options in a particular area. While veto actors have an institutional, partisan, or situational veto over reform, proposal actors play a critical role by introducing

intellectual innovations, setting agendas, and defining the range of feasible policy outcomes. Some proposal actors are also veto actors, and this clearly strengthens their position in the policy process, but some are not, and still manage to have a substantial influence on the outcomes of reform. To reformulate Tsebelis' hypothesis, the greater the number of veto and proposal actors, and the greater the distance between them, the less radical policy change is likely to be.

H2 (revised): The fewer the number of veto and proposal actors and the lesser the distance between them, the greater the opportunity for change in the scope and size of the PAYG pension system.

Interest groups. Interest groups may be of two types: civil society interest groups that represent independent, non-state actors, and state interest groups that represent the interests of some part of the state bureaucracy. Interest groups that wish to access the policy process can attempt to act as veto or proposal actors or as both. Often interest groups are not concerned with the overall shape of reform, and do not develop fully-elaborated reform proposals, but instead seek to alter some facet of reform that is of particular interest to them. Regardless of their objectives, interest groups find their opportunities restricted by the structure of political institutions. Some political institutions offer better access to critical "veto points" in the policy process than others (Immergut 1992), or privilege certain types of access. For instance, an interest group that has close relations with a dominant party in parliament may have a good chance of influencing policy in a parliamentary system, but little chance in a presidential system. This leads to the following hypothesis:

H3: The impact of interest groups depends on their relations to and distance from important veto and proposal actors, their ability to mobilize constituencies to exert pressure at critical veto points, and their ability to act as veto or proposal actors themselves.

2.3 INTERNATIONAL ORGANIZATIONS AND IDEAS

While only domestic actors have veto power over reform, international organizations often have a powerful agenda-setting capacity, through the formulation and diffusion of reform ideas. In developing country social policy, it is impossible to ignore the role of international institutions, particularly the work of the World Bank in producing "politically-relevant intellectual innovations" (see Figure 2). Deacon's work on the evolution of a "global social policy discourse" provides one way of assessing the role of international organizations (Deacon 1997). Deacon shows that international organizations -- and individual consultants and staff members within them -- contribute diverse perspectives that together form part of a global social policy discourse that constrains national policy. International organization also intervene directly in national social policy processes: the World Bank offers advice on social safety nets and sets conditions on social policy loans; the IMF imposes loan conditions that often limit social sector budgets; the European Union distributes structural funds and promotes an obligatory social chapter; USAID funds policy development and public outreach. Deacon argues that the World Bank and IMF have been the most influential international actors in postcommunist social sector reform (Deacon 1997).

World Bank involvement in postcommunist social sector reform therefore can be divided into two categories: contributions to policy discourse and direct policy interventions (see Figure 2). World Bank direct interventions include all forms of technical assistance, including the sending of missions, financial assistance, and the secondment of Bank employees to national policy offices. For instance, in Poland a World Bank official was appointed head of the Office of the Plenipotentiary (OP) for Social Security Reform. Other activities of the OP also were supported by the World Bank. Interventions of this sort provide one major channel by which policy innovations are transmitted by the Bank to particular national arenas. Global social policy discourse includes publications and conferences sponsored by the World Bank, and the production of ideas. Both direct policy interventions and contributions to global social policy discourse play a powerful role at different times, and in different ways. This leads to a fourth hypothesis:

H4: The World Bank influences pension reform through direct interventions and through contributions to global social policy discourse. Greater exposure to World Bank ideas and greater World Bank intervention in policy planning should therefore lead to more fundamental pension reform.

This section has developed a set of hypotheses based on the Weir-Skocpol model, and recent work by Tsebelis and Immergut on how political institutions structure the opportunities for policy change. However, a major economic reform process really cannot be captured by a static model, but has to be understood as a dynamic process that evolves across time.

3 STAGES AND TRADEOFFS IN THE POLICY PROCESS

The pension reform policy process can be divided into three distinct stages: commitment-building, coalition-building, and implementation. Deliberation at each stage in the policy process has different purposes, actors, and outcomes, and takes place in different deliberative fora. This section describes the three stages of the policy process and the major deliberative fora. It suggests that policymakers face two sets of tradeoffs in reform deliberation: tradeoffs across policy stages and tradeoffs across deliberative fora. A brief description of the three policy stages, fora, and tradeoffs is followed by a discussion of the specific timeline of reform in Kazakhstan, Hungary, and Poland.

Commitment-building. The policy process for pension reform begins with a variety of actors, each with distinct interests and points of view, trying to decide whether to make a commitment to reform. In the commitment-building phase, the main actors are government agencies, their consultants (including those from international organizations), institutional veto actors, political parties, and in some cases civil society interest groups. Commitment-building can be considered to have started when the government first takes official action towards developing a pension reform proposal. Often, a multiplicity of government agencies and consultants present a range of fundamentally different proposals for pension reform at this stage. The distance between proposals may vary, but in postcommunist Europe, they have tended to be polarized into ones that call for a "rationalization" of the existing pension system, and ones that call for "fundamental reform" (Rutkowski 1998; Nelson 1998). Reformers' objectives during the commitment-building stage are to persuade key veto and proposal actors to support reform, and for the government to adopt a single proposal for pension reform through a vote of the full cabinet. Reaching this point, however, involves extensive bargaining, debate, and negotiation, during which

conflicting conceptions of the public interest and the weight of special interests come into play. Fundamental decisions about the nature of reform are usually made at this stage. In all the cases studied here, government commitment to reform was signaled by the creation of a special office or working group for pension reform. I define the creation of such a special office, with a clear mandate to develop and pursue a single type of pension reform, as the culmination of the commitment-building phase.

Coalition-building. Once government commitment to a single program of pension reform has been secured, a second phase of the deliberative process begins, that of coalition-building. Government commitment to reform is often not enough. Legislation is usually required, so pension reform must be carried out through a legislative process, in which the rules of legislative procedure must be followed. In all cases, this means getting the reform passed by majority vote in parliament. The legislative process empowers partisan veto actors -- the parties that make up a governing or single-issue coalition in parliament.

Because pension systems depend on the participation and trust of the population, interest groups cannot be ignored either. Some interest groups may be effective veto actors, others proposal actors, others potential future veto actors, and others possible sources of anti-reform mobilization. Pension reform requires spontaneous mass compliance to succeed, so any anti-reform mobilization is a major threat. A public information campaign is usually launched to win “diffuse” support from the population for reform, and to provide necessary information about how to participate in the reformed system. The two objectives of the coalition-building stage are: 1. To get the reform passed in parliament; and 2. To win diffuse support of the population and organized interest groups to prevent anti-reform mobilization.

Implementation. A further deliberative stage begins with implementation of reform legislation. Although implementation normally is not considered a stage in the policy-making process, it should be. Numerous issues arise in the early implementation stages that were not resolved in reform legislation, and cry out for further regulation or legislation. Deliberation at this stage tends to accentuate the role of business organizations involved in implementation, and interest groups that may be aggrieved by some aspect of the reform. Wholly new actors often enter the process, in some cases created by implementation. Amendments and changes during the implementation phase often result. The implementation phase never properly ends, but deliberation within it is likely to be particularly intense in the first few years.

3.1 TRADEOFFS ACROSS DELIBERATIVE FORA

Deliberation among actors in the social policy process takes place through three distinct types of deliberative fora, whose institutional structure marks the course of negotiation:

1. Governmental bodies
2. Parliamentary bodies
3. Public deliberative bodies

Governmental bodies include the full cabinet, economic committees of the government, and special pension reform working groups. Parliamentary deliberative bodies include standing committees of the parliament, special parliamentary committees, party caucuses, and plenary sessions. Public deliberative bodies include the tripartite councils for social and economic accord that are common in postcommunist Europe, and other bodies that bring together representatives of government and non-state actors.

It is important to point out that all pension reform actors (government agencies, consultants, political parties, business and civil society organizations) may engage in deliberation in multiple fora and that some actors are privileged in one forum as opposed to another. For instance, deliberation in parliament tends to empower partisan veto actors, while deliberation within the government may focus on the concerns of key ministers, and deliberation in public bodies may empower certain interest groups over others. International organizations and their consultants are generally most influential in deliberation within governmental bodies and weakest in public deliberative bodies, although they can counteract this weakness by funding public relations campaigns that have an impact on debate in all three fora.

Secondly, while reform programs may have to be debated in all three types of deliberative fora, deliberation in one forum may substitute for debate in another, to some extent. For instance, trade union representatives may agree not to hold up pension legislation in parliament if it is first negotiated in a national tripartite council. Opponents of reform within the government may choose not to raise objections in the cabinet, but instead to pursue their concerns in parliament, where they have a greater chance of success. Likewise, exclusion of actors from negotiations in one deliberative forum will often cause them to seek representation in another. This discussion suggests the following hypothesis:

H5: There are tradeoffs across deliberative fora. In particular,

- *Choice of deliberative fora systematically influences reform outcomes because certain fora empower certain types of actors;*
- *Exclusion of actors from one deliberative forum will often cause them to be more active in another.*

3.2 TRADEOFFS ACROSS POLICY STAGES

In addition to tradeoffs across deliberative fora, path dependency across policy phases means that developments in one phase have repercussions in succeeding phases. This again implies tradeoffs across phases. In particular, veto and proposal actors excluded from deliberation at one stage in the policy process often become more active in a later stage. Since basic design issues are decided at the commitment-building stage, excluding one or more veto or proposal actors from deliberation at this stage is expected to produce agreement around a more radical reform proposal more quickly. However, excluded veto or proposal actors have more reason to mobilize during the coalition-building or implementation stages, and therefore may be able to block or delay reform, or exact greater concessions at these stages. Including actors earlier might reduce their anti-reform mobilization, but cause less radical or slower reform. These considerations suggest the following hypothesis:

H6: There are tradeoffs across phases of reform. In particular,

- *The smaller the number of veto and proposal actors involved in design of reform at the commitment-building phase, the faster and more radical the reform.*
- *However, excluding veto and proposal actors at the commitment-building phase may cause them to mobilize effectively against reform in later phases.*
- *Inclusive negotiation of basic design issues at the commitment-building phase will reduce the potential threats to reform at later stages, but at the expense of more time and less radical reform.*

3.3 TIMELINE OF PENSION REFORM IN THREE COUNTRIES

The timelines for the commitment- and coalition-building phases of the policy process in Kazakhstan, Hungary and Poland are mapped in Table 2. Time provides a useful proxy for the inclusiveness of the deliberative process and the strength of veto actors at particular stages. Time also represents one of the greatest costs of reform. The three cases presented here exhibit a wide variation in deliberative time. This variation correlates with major differences in the number and distance of veto and proposal actors involved in pension reform in the three countries. Kazakhstan had the shortest deliberative process, of seven months, while Hungary occupies an intermediate position, and Poland had the longest deliberative process. The following section introduces comparisons between the three cases across time, stages and deliberative fora.

TABLE 2. TIMELINE OF PENSION REFORM IN THREE COUNTRIES

	Kazakhstan	Hungary	Poland 1	Poland 2
1 Government takes official action to begin planning reform	November 1996	June 1995	December 1994	
2 Government establishes special office/working group solely responsible for pension reform	November 1996	April 1996	April 1996	
3 Government approves unified reform project	March 1997	May 1996	April 1997	
4 Reform laws submitted to parliament	May 1997	May 1997	June 1997	May 1998
5 Parliament passes reform laws	June 1997	July 1997	August 1997	December 1998
6 Reform implemented	January 1998	January 1998		January 1999
7 Commitment-building (1-2)	0 months	10 months		16 months
8 Coalition-building (2-5)	7 months	15 months		32 months
9 Total (1-5)	7 months	25 months		48 months

3.3.1 COMMITMENT-BUILDING

Commitment-building is the process by which a government comes to agree on the fundamental design of a pension reform program. Time to commitment varies considerably across the three cases,

from 0 months in Kazakhstan to 10 months in Hungary to 16 months in Poland. A large part of the reason why Kazakhstan moved so swiftly is that it had few veto actors and thus avoided extensive debate within the government over its commitment to reform. Kazakhstan also was quick to establish a single governmental commission for pension reform, under the direct authority of the prime minister, with full approval of the president. The commission was headed by a leading reformer, Grigori Marchenko, and included officials from all relevant government agencies.

Governments in Hungary and Poland took far longer to reach a clear government commitment to pension reform. This was because of the relative multiplicity of veto and proposal actors involved in the commitment-building process. In Hungary, pension reform plans were elaborated by three separate governmental agencies: a working group in the Ministry of Finance with World Bank assistance, a group of experts in the Ministry of Welfare cooperating with German consultants, and the Pension Insurance Fund, a quasi-autonomous state agency whose supervisory board included elected representatives of the major trade unions and business associations. Attempts to reconcile these three plans took 10 months. In Poland, commitment to a single reform proposal was held up for 16 months by a dispute between the Minister of Labor and Social Policy and the Minister of Finance over basic design and the objectives of reform. The Minister of Labor's proposal called for a set of amendments to the first-pillar state system, while the Minister of Finance advocated setting up a funded second pillar and re-regulation of the voluntary third pillar. Their mutual vetoes resulted in a stalemate within the government until a new prime minister was appointed and he replaced the Labor Minister with one who was sympathetic to multi-pillar reform. At that point, the government established a special Office of the Plenipotentiary for Social Security Reform, at first under the authority of the new Labor Minister, and later under the prime minister's office, a major turning point in the reform effort.

Commitment-building in Hungary and Poland took longer than in Kazakhstan because their political institutions empowered a broader range of veto and proposal actors. In Hungary and Poland, with their parliamentary democratic institutions, government decisions require a majority vote of the cabinet, and thus individual ministers leading sufficient factions can play an effective veto role in the commitment-building phase. Kazakhstan's authoritarian institutions centralize power in the presidency and make individual government ministers less likely to formulate alternative reform proposals. Civil society organizations also face greater sanctions for voicing opposition in Kazakhstan and fewer opportunities to access the policy process. Since pension reform deliberations were kept secret, civil society groups did not even know about the progress of governmental pension reform proposals until a commitment had been reached. Tight information controls in the Kazakh case reduced the scope for open debate and deliberation within and outside the government. However, Kazakhstan also made an important strategic decision to establish a special working group for pension reform from the outset, inviting all the major players to the table, and thus heading off the potential for individual agencies to work on their own independent programs. In the other two cases, the lack of a single working group early on and the existence of multiple governmental veto and proposal actors caused internal deadlock in the commitment-building phase.

3.3.2 COALITION-BUILDING

Poland (32 months) and Hungary (15 months) also had longer consultative processes in the coalition-building stage than Kazakhstan (7 months), for similar reasons. Kazakhstan's authoritarian political institutions reduced the number of veto actors and enabled the government to push its reform program quickly through the public deliberative and legislative processes. Neither the parliament nor any political party were veto actors in Kazakhstan because of a clause in the Kazakh constitution that allows the president to force some urgent legislation through parliament under threat of dissolution. After four months of deliberation within the government special commission for pension reform, the Kazakh reform plan was published in the press in March 1997. Public deliberation continued until May 1997, when a slightly revised program was presented to parliament and passed in June 1997 with minor changes. Negotiation with actors outside the closed special commission in Kazakhstan took only three months.

Hungary's coalition-building process was considerably slower. Hungary spent nine months elaborating reform proposals and winning the support of ministers and partisan veto actors within the government coalition. At the start of 1997, the government spent four months in public deliberation, including discussions in Hungary's tripartite council and meetings with a wide range of public interest groups, social institutions, and political parties. As a result of this prior work, and the fact that the government had a large majority in parliament, the parliamentary process in Hungary went exceptionally quickly, for a parliamentary democracy. Approximately two months after being submitted, the major pension reform laws were passed by parliament, for a total of 15 months, compared to seven in Kazakhstan.

Poland had the longest coalition-building process, in part because the full set of reform legislation could not be pushed through before the end of the parliamentary term in September 1997. The center-left coalition government included strong internal factions that opposed the reform, necessitating a single-issue coalition with one of the main opposition liberal parties in parliament. In this context, the new plenipotentiary decided to pursue the least controversial part of the reform legislation first, with provisions that would tie any future government to a specific timetable for reform (Hausner 1998). Three laws were passed in August 1997, but two of the most controversial laws were left for the next government to prepare. In the second stage of coalition-building in Poland, parliamentary deliberation turned into a lengthy ordeal. Poland's two-stage process, finally completed in December 1998, resulted in the longest coalition-building process of the three cases considered here. Poland's numerous veto and proposal actors, changing over time and across electoral cycles, contributed to its length.

3.3.3 IMPLEMENTATION

In all three cases, important regulatory decisions were taken after the approval of pension reform legislation and after the start of reform implementation itself. In Kazakhstan, several important pension reform regulations were written after the official start of implementation. In Hungary, important changes in the pension reform law were made post-hoc by a new government, and in Poland several aspects of reform, including negotiations on special privileges and a law on a national actuary were

debated after the passage of the main pension reform legislation. In all three cases, deliberation and policy-making continued into the implementation stage.

New actors also emerged in the implementation stage and pushed for amendments to the pension system. In Kazakhstan, for instance, trade unions were quiescent throughout the brief deliberative process, but began to mobilize against reform after legislation was passed, pushing for a reinstatement of special pension privileges. In Hungary and Poland, newly-formed pension funds became major players in the implementation stage, after having been relatively uninvolved earlier. In Hungary, new partisan veto actors in the early implementation stage caused a reversal of some key aspects of the reform.

Because of tradeoffs across policy phases, problems with implementation are sometimes related to the exclusion of potential veto and proposal actors at earlier phases. Kazakhstan, which had the fewest institutional veto players, and consequently the fastest coalition-building stage and the most radical reform, also faces the greatest challenges in implementing reform. Hungary's commitment- and coalition-building processes focused on gaining consensus within one coalition government and its affiliated civil society organizations, but experienced policy reversals when a different coalition came to power during implementation. Poland, with the most drawn out commitment- and coalition-building processes, may have the least conflictual implementation, since all major parties have supported reform at one time or another. Although only time will tell, inclusiveness may enhance efficiency of implementation.

4 IMPACTS OF DELIBERATION

How have political-institutional structures and processes affected reform outcomes? When analyzing outcomes, it is important to distinguish between three types of changes produced through deliberation among proposal and veto actors across time:

1. technical changes
2. public-interest changes
3. special-interest changes

Technical changes are the most numerous outcomes of the policy process. As the plan is debated, it is often enriched by numerous amendments and provisions offered by consulted parties with access to specialized sources of information. They include all sorts of alterations intended mainly to improve the efficiency and technical coherence of the program, but tend not to have broad distributive impacts. This is one of the most important reasons for a sufficient deliberative process. Extensive deliberation holds the danger of watering down reform, but it may also lead to substantial improvements (cf. Palacios and Rocha 1998, 20).

I define "public-interest changes" as changes that have broad distributive impacts, but ones that are either universal or tend to encompass a wide cross-section of groups involved in the reform, for instance changes to the retirement age. Such changes do not respond mainly to specific interest group demands, but rather to differing conceptions of the public good. Public interest considerations lead to some of the most controversial debates among veto actors in the pension reform process. Key among

these is the debate over whether a three-pillar pension system, including a large second pillar, is in the public interest. This depends on an individual country's situation (Holzmann 1998). The process of a society debating the interests of its citizens now and in the future is bound to be controversial. Similarly, the retirement age, which is something that affects all working citizens, has proven to be a sharply controversial issue. Often, these debates are not animated by the attacks of special interest groups on obvious public interests, but rather by differing conceptions of the public interest held by different groups pursuing what they believe is the common good. Proposal and veto actors tend to represent different conceptions of the public interest.

Special interest group changes are usually easy to identify: they include all types of special provisions that affect one or a small group of interested parties, for instance, special retirement provisions for miners, military officers, or judges.

5 PROCESS AND OUTCOMES IN KAZAKHSTAN, HUNGARY, AND POLAND

The following case studies analyze how different policy legacies, political institutions, veto and proposal actors, and international organizations affected the pension reform process and outcomes in three postcommunist countries. Each case concludes with an evaluation of the six hypotheses developed in the previous sections in light of the evidence presented in the case.

These hypotheses are restated below:

H1: Policy legacies influence present reform choices. In particular,

- Countries with higher implicit pension debt will choose a smaller private pillar and retain a larger PAYG public pillar, in other words, less radical reform.*
- Other pension reform design elements will build upon the legacies of pre-existing pension institutions.*

H2: The fewer the number of veto and proposal actors and the lesser the distance between them, the greater the opportunity for change in the scope and size of the PAYG pension system.

H3: The impact of interest groups depends on their relations to and distance from important veto and proposal actors, their ability to mobilize constituencies to exert pressure at critical veto points, and their ability to act as veto or proposal actors themselves.

H4: The World Bank influences pension reform through direct interventions and through contributions to global social policy discourse. Greater exposure to World Bank ideas and greater World Bank intervention in policy planning should therefore lead to more fundamental pension reform.

H5: There are tradeoffs across deliberative fora. In particular,

- *Choice of deliberative fora systematically influences reform outcomes because certain fora empower certain types of actors;*
- *Exclusion of actors from one deliberative forum will often cause them to be more active in another.*

H6: There are tradeoffs across phases of reform. In particular,

- *The smaller the number of veto and proposal actors involved in design of reform at the commitment-building phase, the faster and more radical the reform.*
- *However, excluding veto and proposal actors at the commitment-building phase may pose threats and require greater compromises in later phases.*
- *Inclusive negotiation of basic design issues at the commitment-building phase will reduce the potential threats to reform at later stages, at the expense of time and less radical reform.*

Kazakhstan, Hungary and Poland display wide variation in their policy legacies (discussed above; see Table 1) and their political institutions. Kazakhstan is a presidential system which "gives the president and his office control over almost every aspect of the republic's political and economic life" (Olcott 1997, 106). The president is really the sole veto actor in the system, although in the case of pension reform, he allocated veto power to a special working group under the authority of the prime minister, whom the president appoints. Parliament is no longer an institutional veto actor in Kazakhstan since the 1995 constitution did away with its emerging veto power (Olcott 1997, 112). Hungary and Poland, by contrast, are mainly parliamentary democracies (although Poland also has a directly-elected president), in which governments are formed by coalitions of parliamentary parties. This gives partisan veto actors a much greater role in policy formulation. Civil society interest groups also have greater opportunities for access to the policy process in parliamentary democracies, through their ties with political parties. Political institutions determine the number of institutional and partisan veto and proposal actors in each case, making the policy environment in Hungary and Poland far more challenging for fundamental reform.

Case studies are organized by hypothesis and policy phase. The first section of each case study discusses the policy legacies that shaped reform, with a particular focus on implicit pension debt. A second section covers the commitment-building process, focusing on the main veto and proposal actors within the government and the role of international organizations, including the World Bank, in providing policy advice. The third section, on coalition-building, analyzes the process of deliberation with interest groups in public and parliamentary bodies, with an emphasis on tradeoffs across deliberative fora. The fourth section, on implementation, looks at the outcomes of reform, and any major policy changes that occurred during implementation, analyzing them in the context of tradeoffs across policy stages. Finally, a concluding section reviews evidence from each case that speaks to each of the main hypotheses.

5.1 KAZAKHSTAN

5.1.1 POLICY LEGACIES

At the outset of reform, Kazakhstan spent substantially less on pensions as a proportion of GDP than either Hungary or Poland (see Table 1), and had a smaller implicit pension debt (IPD). James (1998b) estimates Kazakhstan's implicit pension debt (the present value of accrued rights of pensioners and workers under the old system) at 88% of GDP, compared to 213% in Hungary and 220% in Poland. Yet despite smaller pension obligations, Kazakhstan experienced a dramatic pension arrears crisis. Kazakhstan, like Russia and Romania, had initially controlled pension spending by accumulating substantial payment arrears to current pensioners (Cangiano et al. 1998, 10) and by not indexing pensions to keep up with inflation. In 1996 and 1997, Kazakh pension arrears were so severe that mass protests of pensioners broke out in cities across the country. A collapse in state ability to tax was a large part of the problem, reflecting the extent of the so-called gray economy, as well as a steep decline in production from Soviet times. Few small private businesses paid any pension payroll tax at all. Mass protests and system failure seemed to call for radical measures, and the Kazakh government responded with a radical pension reform, introduced in tandem with an effort to pay off all existing pension arrears.

5.1.2 COMMITMENT-BUILDING

	Proposal actor	Veto actor
Working group	x	x
President		x
Total	1	2

Kazakhstan began its pension reform process with full governmental commitment to reform. Its ability to do so reflected the small number of institutional veto actors in its strong presidential political system. With authoritarian political institutions and a centralized policy style, Kazakhstan was able to circumvent open disputes between different ministries and government agencies that broke out in the first stages of commitment-building in Poland and Hungary. Reformers achieved this by winning presidential approval for the reform at the outset and setting up a special interministerial commission for pension reform that would monopolize proposal authority within the government, under the political sponsorship of the prime minister. This meant that the Kazakh reform was dominated from the start by one proposal actor, whereas Hungary and Poland had several competing ones.

The reform process started in November 1996 when President Nursultan Nazarbaev and Prime Minister Akezhan Kazhegeldin appointed Grigori Marchenko Chairman of the National Securities Commission and Natalya Korzhova head of a newly consolidated Ministry of Labor and Social Protection. Marchenko was put in charge of a special government working group on pension reform that included the Prime Minister, Deputy Prime Minister and Minister of Finance, the Chairman of the Central Bank, the Minister of Labor and Social Protection, the head of the National Securities Commission, two persons from the private sector, and two members of parliament. Marchenko had previously worked at the National Bank of Kazakhstan, and was a protégé of reformist Prime Minister

Kazhegeldin. Marchenko reports that it was important to get people from different agencies to head off potential misunderstandings and lack of coordination down the road (interview, July 1, 1998).

International organizations were also involved, providing both policy ideas and direct technical assistance to the pension reform working group. Chief reformer Grigori Marchenko reports being heavily influenced in his thinking about pension reform by reading Averting the Old Age Crisis and attending World Bank-sponsored conferences (interview with Marchenko, July 1, 1998). The basic framework for pension reform in Kazakhstan was thus transmitted largely through reformers' own interpretations of World Bank policy ideas, without direct technical assistance from the Bank at the early stages. Direct technical assistance was provided by USAID. The World Bank sent an expert advisory mission to Kazakhstan in May 1997, after major design decisions had been made. However, the World Bank later decided to loan \$300m to Kazakhstan to implement reform. USAID technical assistance gave the main proposal actor an unparalleled advantage. Given the lack of technical expertise in Kazakhstan and the lack of resources on the part of civil society groups, 'no one else was technically in a position to develop a model' for analyzing or developing different pension reform proposals (interview with Marchenko, July 1, 1998), and thus the working group easily dominated expert debate.

Secrecy also enhanced the working group's monopoly on reform proposals, sharply restricting the ability of civil society and other interest groups to influence reform. Even high-ranking government officials in affected ministries were not informed of the progress of working group deliberations. This allowed the government to develop a more radical reform program more quickly than in other transition countries, although at the cost of widespread disapproval from civil society groups and anti-reform mobilization during implementation.

After four months of deliberation, the working group on pension reform had prepared the outlines of a radical, three-pillar reform, in the form of an eight-page 'draft concept' that was published in the Kazakh press on March 20, 1997. In essence, the draft concept proposed changing the Kazakh pension system from a pay-as-you-go system paid for by a 25.5% payroll tax to a funded system based on a 10% employee contribution, with a minimum pension guarantee. The pay-as-you-go system would be phased out over a ten-year period. Later amendments, however, extended the transition period. Disability and survivor benefits would be transferred to the central budget, all special privileges eliminated, and new recording and financial mechanisms put in place. Private pension funds would collect and invest employee contributions, aiding the development of Kazakh capital markets.

Kazakhstan's commitment-building process was swift, marked by the quick formation of a working group on pension reform that brought together all the key governmental actors. Full presidential support and the lack of alternative veto or proposal actors within the government enabled the working group to produce the most fundamental reform of the three cases. Later stages of public and parliamentary deliberation did not substantially change the basic outlines of reform, agreed in the working group's secretive four-month session.

5.1.3 COALITION-BUILDING

	Proposal actor	Veto actor
Working group	x	x
President		x
Total	1	2

The coalition-building process in Kazakhstan was characterized by cursory public and parliamentary deliberation. Although the government was obliged to submit the reform program to some debate, Kazakhstan's strong presidential system meant that there were no real partisan or civil society veto or proposal actors. Parliament was the main deliberative forum, but had no actual veto power. Interest groups still managed to influence the process to some extent, but only within the bounds of what the main veto actors would allow.

The Kazakh government allocated two months for public discussion of the new pension system. Public deliberation began on March 20, when the government published its draft concept paper in the press, and lasted until May 12, when the government approved a revised concept for pension reform. During this time, a deputy minister of labor and social affairs initiated the solicitation and consideration of public commentary, collecting approximately 200 letters and interest group comments. However, the same deputy minister, a former opposition trade union leader, notes that the government had not previously intended to consult with interest groups and that this was undertaken on her own personal initiative (interview with Sivriukova, July 6, 1998). In addition, two teams of government representatives toured the country in April and May to promote the new pension reform concept and gather public reactions, meetings that were widely reported in the press. Public deliberations also took place in tripartite council meetings in April. The main trade union federation expressed dissatisfaction with the government proposal and rejected the three-pillar design (*Kovcheg*, 1 May 1997). The leader of the second leading trade union accepted reform, because he believed it to be a fait accompli. Still, trade unions criticized the rushed deliberative process, saying it deprived interest groups of voicing their concerns (*Kovcheg*, 1 May 1997).

The government ignored widespread public opposition expressed in the press and public opinion polls. Groups such as the Federation of Kazakh Trade Unions, the association of labor and war veterans, and several pensioners associations came out against the reform. Some government social security officials also expressed opposition to the reform (*Kazakhstanskaya Pravda* 25 April 1997), reflecting limited support and deliberation within the government itself. There is no evidence that the government concerned itself with rallying diffuse support of the population, as only limited resources, mostly provided by USAID, were allocated to public relations and public awareness campaigns. Public support would have been difficult to obtain in any case, since the government was dealing at the same time with a massive pension arrears crisis, causing mass protests around the country.¹

¹ In one instance, on August 18, 1997, a crowd of several hundred angry pensioners demonstrated against pension arrears in the central square of Taraz, a city in south Kazakhstan. They gathered in front of the mayor's office, blocking traffic on one of the city's main thoroughfares for three hours, chanting slogans including, "Give us pensions!", "We want to eat!", and "We don't believe you! You lured away our kopeks!" (*Express K*, August 19, 1997).

The government chose to tradeoff extensive deliberation and coalition-building for quicker implementation of reform. Its main imperative was to submit pension reform legislation to parliament in time to begin implementation in January 1998. Legislative drafting had started already in April, while public deliberation was under way. Nonetheless, deliberation in the various public fora listed above did produce a handful of changes. Most of these were technical, including ten to twenty instances of rewording for consistency and technical reasons, and about ten alterations made after consultation with various international organizations. However, four new provisions clearly reflected the impact of special interest groups, while seven appeared to respond to broadly-expressed public interest concerns.

Initially, the Kazakh reform intended to eliminate all special pension privileges. However, between March and May 1997, military and internal affairs officers managed to make their voices heard. Four new provisions granted special exemptions and benefits to the military, employees of the Agencies of Internal Affairs and the State Investigation Committee (former KGB). The so-called "power ministries" were the only lobby able to gain a guarantee of special treatment under the proposed new system. The May 1997 draft exempted anyone with ten years of service or more from being affected by the change to the new pension system. The power ministries also won a lower retirement age and higher benefits for their employees under the new system. New entrants into the military, security, and intelligence services and those with less than ten years of service were awarded a 20% contribution to their pension accumulation funds, paid for by the state, double the 10% for all other categories of employees.

Several changes also addressed broad public concerns expressed through multiple deliberative channels. Kazakhstan's privatization experience left the public with a low regard for private investment funds, which translated into mistrust of private pension funds. This came across clearly in the press and public meetings held around the country (interview with Marchenko, July 1, 1998). In response, the government introduced in its revised program a State Accumulation Fund that citizens could choose over private, non-state accumulation funds. The State Accumulation Fund would provide greater security through tighter investment controls and a state guarantee, with the tradeoff of potentially lower returns. This provision proved to be very important as more than 85% of citizens initially entrusted their contributions to this state fund, severely limiting the extent of private management in the funded pillar. The State Accumulation Fund's dominant share of the "private" market had declined to approximately 70% of total assets by late 1999.

The May 1997 draft concept also promised price indexation of benefits to beneficiaries of the old state system. Although legally, this would reduce indexation levels by supplanting wage indexation, the March 1997 draft had contained no reference to indexation at all, and in practice a consistent price indexation would benefit current pensioners more than the ad hoc wage indexation of previous years.

The May 1997 draft increased from 10% to 15% the amount of payroll contribution allocated to the old system, and increased from 10 to 15 years the length of time to phase out this tax. Although this could be regarded as a technical finance question, the amount of money the government collects had a direct impact on outlays in the past. When insufficient funds were available, the government had not paid pensions, but rather allowed arrears to accumulate. Given this track record, this increase in contribution rates to the old system will likely have a strong distributive impact in favor of current pensioners. The May 1997 draft also included a vital promise to repay pension arrears, a condition

demanding by the World Bank for its continued assistance to Kazakhstan and by USAID to reestablish confidence in the pension system (USAID 1997). The new concept reduced from 30 to 25 (men) and 20 (women) the requisite work periods for minimum pension eligibility under the new system. It promised no decline in take-home pay as a result of the introduction of a 10% employee contribution to the accumulation funds. Finally, the new draft promised to retain the value of disability and survivors' pensions transferred to the state budget, although the government probably intended this as a method of controlling costs (USAID 1997).

Public deliberation over the concept paper from its publication in the Kazakh press on March 20, 1997 to its adoption by the government on May 12, 1997 resulted in only a handful of changes. Many of these responded to suggestions made by international organizations, most importantly USAID and the World Bank. Only a small number responded to particular interest group or broadly-expressed public concerns, but some major changes were introduced, particularly the State Accumulation Fund that became the largest pension fund in the first months of the program, reflecting widespread distrust of private fund managers. A short period of public consultation, and the lack of information about the pension reform before March 20 were the most important limiting factors.

Public discussion of the pension reform issue increased as the plan moved closer to implementation and people realized that the program would affect their future benefits. However, increased public discussion -- and opposition expressed by most groups, experts, and the majority of the population in the press and public opinion polls -- had only limited impact on the outcome of debates in the Mazhilis, Kazakhstan's lower house of parliament.

Parliament was not a veto actor in the Kazakh reform, but it provided an important deliberative forum nonetheless. Kazakhstan's president submitted the draft pension reform law to parliament marked "urgent," a legislative procedure which meant that the parliament had only one month to debate, amend, and pass the law or risk being dissolved by the president. In this case, the law would be passed by presidential decree. Threat of dissolution militated against making major changes to the law. As one Kazakh newspaper explained in a news analysis piece, the dissolution threat presented deputies (Mazhilis) with a difficult dilemma: If they voiced public concerns and voted against pension reform, they would lose their positions and pension reform would be accepted by presidential decree. If the deputies voted for reform, they would face public outrage in upcoming parliamentary elections in September. Constituents in several districts had threatened to recall deputies who voted for reform (*Express K*, 29 May 1997). Mazhilis (deputies) were truly between a rock and a hard place, with little opportunity for effective voice.

Deputies tried to resolve this dilemma by expressing public concerns and even outright opposition, but at the same time accepting the firm constraints the government team placed around acceptable compromises. Parliamentary deliberation thus took two forms: purely rhetorical deliberation and a parallel, somewhat more secretive, process of actual reform amendments, that were few in number. Very few parliamentary deputies spoke in favor of the reform program and the pro-reform side was represented directly by the government reform team itself, unusual in parliamentary practice. One newspaper described the debate as "fervent", but also said that the attempt of the deputies to paint the reform as "anti-social" tended to break down when facing the "threatening" faces of the government team (*Kustanaiskiye Novosti*, 27 May 1997). Parliament voted overwhelmingly for the reform in

June, despite the hostility of many parliamentarians to the reform in full or in part, in order to guard against dissolution.

In the course of deliberation, the government was forced to concede a few points to parliament. The main changes were to the system of state guarantees, the phasing out of the old state program, the retirement age, and special benefits. The Mazhilis voted not to increase the pension age to 65, as proposed in the government draft, but to end a phased increase already in progress in 2001, when the retirement age reaches 63 for men and 58 for women. Mazhilis deputies had protested increasing the retirement age further on the grounds of the low and decreasing life expectancy in Kazakhstan.

Secondly, the Mazhilis managed to get two special interest provisions included in the law. Lower retirement ages were granted to a) citizens who lived in zones of extreme and maximum radiation risk (the top two radiation risk zones) for not less than ten years between 1949 and 1963 (victims of the Soviet Union's nuclear test program); and b) women in rural areas with five or more children. Interestingly, the Mazhilis voted against extending special pension benefits to employees of the interior ministry and state investigation office (former KGB) (*Selskaya Novi*, 12 June 1997). However, special benefits for these two groups were reinstated in the Senate, a body more closely controlled by the president. The government lobbied insistently for the reinstatement of these special benefits, despite the declared goal of the reform to eliminate pension privileges (*Panorama*, 13 June 1997). Efforts by senators to grant special benefits to other groups, including steel workers, miners, prosecutors, and judges, failed.

However, the majority of changes introduced by the Mazhilis were public-interest and technical, rather than special-interest, changes. These included:

- Eliminating the 15-year period for phasing out the old state pension contribution, allowing for the prospect of a longer transition period.
- Obliging the state to guarantee the safety of pension contributions to the state accumulation fund, although not to the non-state pension funds.
- Making funeral benefits more generous.
- Excluding accumulations in non-state pension funds from bankruptcy proceedings.
- Allowing participants to choose to change funds twice a year, rather than once.
- Allowing participants to withdraw accumulations when moving permanently abroad.
- Promising that any future pension rules would not infringe the interests of contributors.
- Requiring notification to contributors when a pension fund has its license suspended.
- Adding a few technical conditions to the qualification of pension fund managers and procedures for the liquidation of non-state pension funds.

Despite enormous limitations on the legislative process, parliament succeeded in making a few important alterations to the pension reform law. Most of these concerned broad public interests, rather than special interest provisions. Most important was the decision to extend the phase-out of the old state system and grant state guarantees for moneys deposited in the State Accumulation Fund. This played a role in convincing Kazakh citizens to invest their money in the more secure state fund, given widespread suspicion of private management companies. As mentioned earlier, approximately 85% of contributions were initially directed toward the State Accumulation Fund. Limitation of increases in the

retirement age (to 63/58) may appear to be important, but the effects of this provision will not be felt until 2001. The government hopes to continue this phased increase at that point (interview with Marchenko, July 1, 1998).

In the absence of alternative veto or proposal actors, the government managed to preserve the fundamentals of its reform program throughout the rapid, two-month deliberative process. Reformers in Kazakhstan set out to implement a Chilean-style pension reform, and were highly successful in pushing through their initial proposal. The Kazakh reform eliminates, over time, the current PAYG system and replaces it with a minimum pension guarantee and a mandatory, funded, second pillar (Rutkowski 1998). The law calls for price-indexation of the minimum pension twice a year, but no automatic indexation. From the start of reform on January 1, 1998, all Kazakh employees are required to invest 10% of their earnings in pension funds. An additional 15% of payroll continues to be paid by employers to the existing state defined-benefit program. Previously, the 25.5% contribution rate was paid entirely by employers. Under the current reform, the contribution rate is reduced slightly, to 25%, with 10% showing up on the pay-stub of employees as pre-tax income and allocated to a pension fund of the employee's choice. While more than a dozen private pension funds have been set up, more than 85% of all Kazakh employees initially chose to invest in the State Accumulation Fund, where assets are guaranteed. All workers who contributed for six months into the old PAYG system also will receive benefits from it, making the phase-out period last for decades, until the last contributor dies. Workers entering the labor force less than six months before the January 1, 1998 starting date will derive their entire benefit from the new, funded system.

This fundamental reform of the pension system in Kazakhstan was achieved in seven months, from the start of government planning, to the passage of the program in parliament. Its passage was possible in a political-institutional context with only a small number of veto actors, that did not require extensive changes as a result of deliberation with alternative proposal actors or civil society groups in the coalition-building phase. Only a small number of special interest groups managed to influence reform outcomes, notably employees of the military, interior ministry, and security forces.

5.1.4 IMPLEMENTATION

Kazakhstan passed the quickest and most radical reform to date, measured by the eventual dominance of the funded share in the new system. However, the accelerated legislative process in Kazakhstan had a negative impact on legislative quality and implementation (Rutkowski 1998). Major problems included:

- low contribution compliance in the first months of implementation;
- failure to set up private pension funds in time for the start of reform;
- failure to issue all workers necessary identification numbers;
- more general failure of administrative computer systems;
- lack of public information on how the new system works;
- lack of confidence in private pension funds or reform more generally.

Lack of preparedness for reform implementation was directly related to the speed of reform. The government was determined to complete pension reform before parliamentary elections in September 1998 and presidential elections in 1999. However, this left little time to draft legal regulations, inform the public about the program, or allow prospective pension funds to establish themselves and work out business plans. All of these things began to happen as reform was already under way.

As a result, Kazakhstan experienced serious administrative lapses in the early months of implementation. In January 1998, few contributions were collected, leaving the state center for benefit payments with a substantial deficit. The first private pension funds were not founded until March 1998. Issuance of individual contributors with social identification numbers continued several months into the implementation process. Many regulations needed to supplement the pension reform law were drafted while the reform was in progress during 1998, with USAID providing vital technical assistance (interview with William Baldrige, USAID, July 2, 1998). For instance, the regulation "on qualification requirements applied to the licensee, founders and managerial staff of the accumulative pension funds" was registered on February 11, 1998. Similarly, the regulation of the National Pension Agency that provided for issuing licenses to owners of greater than 25% of shares of open pension funds was registered on March 18, 1998. Since the coalition-building phase is the time reformers have to draft reform legislation, a longer and more inclusive process would have allowed better elaboration of proposals. It would have allowed bringing important partners, such as the private pension funds, into the process at an earlier stage, causing implementation to run more smoothly. Public information about the reform would have been distributed sooner and more extensively had a longer public debate occurred, allowing a variety of different actors to plan and adjust their behavior accordingly. A longer time-frame might also have allowed complicated technical and information technology problems to be worked out before the start of reform.

More inclusive deliberation earlier in the process may have also stymied anti-reform civil society mobilization in the early implementation stage and increased public confidence in the new private pillar. Already in July 1997, air traffic controllers and pilots began efforts to reinstate special privileges they had enjoyed under the old system (*Panorama*, 11 July 1997). In September, miners' representatives traveled to Almaty to press their demands for reinstatement of special retirement provisions (*Panorama*, 5 September 1997). In November, steelworkers, miners, and pilots threatened a nationwide strike on behalf of those professions that lost special retirement benefits (*Kazakhstanskaya Pravda*, 11 November 1997). These claims attracted substantial support in parliament and in mid-1998 a group of deputies began to consider legislation to reinstate a number of categories of special privileges that it had taken away a year earlier. USAID simulations showed that workers in hazardous professions had in fact lost about half their benefits under the reform, but argued that special benefits were not affordable. Instead, USAID recommended that the government should pay for actually disabled workers through the disability system (USAID, 23 April 1998). The fact that 85% of Kazakh citizens and enterprises initially chose to invest in the new State Accumulation Fund over all private pension funds indicates the low level of confidence in the new private pillar. Implementation problems in Kazakhstan can thus be divided into two categories: those that reflected a technical lack and those that reflected a legitimacy deficit.

5.1.5 CONCLUSIONS

This section reviews the findings of the Kazakhstan case study in light of the six hypotheses proposed above. The first hypothesis was that policy legacies, particularly the level of implicit pension debt (IPD), influence reform choices. Kazakhstan had the lowest IPD of our three cases, and, as predicted, the most substantial change to the public PAYG system (James 1998b) and the largest private funded pillar. The second hypothesis is also borne out by the Kazakh case. Kazakhstan had the smallest number of institutional veto actors, and consequently the most rapid reform process and the most radical change. Interest groups were predicted to have an impact that depended on their relations to critical veto actors. In Kazakhstan, because of the small number of veto actors, and particularly the lack of a veto role for parliament or political parties, interest groups had very little opportunity to influence the policy process, except for those connected to the "power ministries" within the government. Exclusion of civil society interest groups contributed to the radical nature of the reform, but also to anti-reform mobilization during the implementation stage. The fourth hypothesis states that the World Bank influences pension reform through direct intervention and policy discourse. Interestingly, Kazakhstan demonstrates the power of policy discourse over intervention. Reformers in Kazakhstan chose fundamental reform without direct interventions by the World Bank (although with substantial USAID interventions), but under the influence of ideas expressed in *Averting the Old Age Crisis* (World Bank 1994) and World Bank-sponsored conferences. Direct World Bank interventions in Kazakhstan came only after major design decisions were made. The fifth hypothesis anticipates tradeoffs across deliberative fora. In Kazakhstan, no deliberative forum was particularly powerful, and there does not appear to have been much of a tradeoff between public deliberation from March to May and parliamentary deliberation from May to June 1997. Both concerned similar issues and both ended in minor, but different, compromises. The sixth hypothesis suggests instead that there are tradeoffs across policy stages, and indeed Kazakhstan shows this quite clearly. Rapid deliberation and legislative drafting in Kazakhstan led to more radical reform, but one that faced extraordinary problems in implementation, including a failure to found private pension funds before the time they were supposed to begin collecting contributions. This contributed to low public confidence in private pension funds, displayed by the preponderance of the State Accumulation Fund in the new "private" pillar. Kazakhstan exhibits both the benefits and drawbacks of a rapid reform with few veto actors, and little input from alternative proposal actors and interest groups. As the following two case studies show, democratic legislative processes in other postcommunist states have forced reformers to take the interests and proposals of a variety of actors into account, lessening the extent of change, but increasing public confidence in the new funded pillar.

5.2 HUNGARY

5.2.1 POLICY LEGACIES

Hungary had a far higher implicit pension debt than Kazakhstan at the outset of reform, approximately 213% of GDP (James 1998b), with higher social security payroll tax rates and approximately double the proportion of GDP spent on pensions (see Table 1). Hungary's pension system was also experiencing a worsening fiscal balance, that deteriorated by about two percent of

GDP between 1991 and 1995, and was financed out of the state budget. Payroll tax levels remained constant at very high levels, while the number of pensioners was increasing rapidly and the average pension was falling at similar rates, about 25% in real terms between 1990 and 1995 (Cangiano et al. 1998). Hungary had been adjusting through ad hoc changes in pension levels, which weakened the link between contributions and benefits. Both institutionally and fiscally, the Hungarian pension system faced severe challenges in the middle of the 1990s (see Palacios and Rocha 1998 for a more complete discussion).

A first step in reform came in 1993, when Hungary created a system of voluntary pension funds in the form of 'mutual benefit societies,' funded largely by tax breaks. The idea was to build civil society by allowing groups of citizens to found their own voluntary pension funds. Organization of these third pillar funds had a major structural impact on the course of later pension reform in Hungary, as interest groups involved in the third pillar lobbied successfully to have the second pillar in Hungary organized along similar lines, a clear instance of how policy legacies may influence later reforms.

However, the creation of voluntary pension funds did not address the underlying fiscal problems of Hungary's pension system. Further progress on pension reform in Hungary was stalled until Lajos Bokros was appointed Finance Minister in early 1995. Bokros was appointed after a year of rule by the Socialist Party under Prime Minister Gyula Horn, during which time the government wavered over economic reforms. The Socialist Party had won parliamentary elections in 1994 on a platform that promised negotiations toward a broad socio-economic pact, and formed a supermajority coalition with the liberal Alliance of Free Democrats. The social-liberal government tried to negotiate a social pact in the second half of 1994 (Hethy 1995). But as Hungary edged closer to a fiscal and currency crisis, Prime Minister Horn appointed Bokros Finance Minister to implement an austerity plan in 1995 that became known as the Bokros package. The Bokros package included major cuts in social sector expenditures, especially in Hungary's system of family allowances, which had been a primary source of poverty relief during the transition. Two prominent leftists within the Socialist Party, Minister of Welfare Pal Kovacs and Minister for National Security Affairs Bela Katona, resigned in protest against these cuts (*Financial Times*, 14 March 1995, 2). This signaled the ascendancy of liberals within the governing coalition and set the context for a new, more radical approach to social sector reform.

5.2.2 COMMITMENT-BUILDING

	Proposal actor	Veto actor
Ministry of Finance	x	x
Ministry of Welfare	x	x
Pension Insurance Fund	x	
Prime Minister/Socialist Party		x
Alliance of Free Democrats		x
Total	3	4

Commitment-building in a parliamentary democracy can be a long and painstaking process, because of multiple veto and proposal actors, and greater ease of access to the policy process by interest groups. Commitment-building in Hungary was complicated by the existence of three major proposal actors in the commitment-building stage: the Ministry of Finance, the Ministry of Welfare, and the Pension Insurance Fund. The distance between their proposals was great (see Table 4). Veto actors were also numerous, including the two ministries, the prime minister and head of the Socialist Party, and the Alliance of Free Democrats, a partisan veto actor whose votes would be needed to pass the reform in parliament. With twice as many veto actors as in Kazakhstan, and three times the number of proposal actors, Hungary would be expected to have a less radical and slower reform.

Hungary's three major proposal actors put forward their own pension reform proposals in 1995-1996 (see Table 3). The distance between them can be seen by looking at their opposing positions on implementing a private, funded pillar. Only the Ministry of Finance pushed for a large funded pillar, while the Ministry of Welfare and the Pension Insurance Fund advocated rationalization of the state PAYG system (Nelson 1998). Opposition was intransigent, creating a rather polarized debate.

Activities of the Finance Ministry working group for pension reform were funded by the World Bank under its Japanese grant facility. Ferge notes that "the better opportunities and resources of the Ministry of Finance. . . had a dominant impact on the whole process" of reform (Ferge 1997, 11). In particular, Ferge points to Finance Ministry dominance in technical capacity, personnel and in attracting media attention. This attests to the power of direct World Bank interventions in developing country policy processes, where alternative proposal actors are unlikely to have access to comparable resources.

While the World Bank played a vital role in strengthening the Finance Ministry in internal governmental debates, including a phase in which the ministry advocated a radical, Chilean-style reform, the Bank ultimately advocated a moderate, multi-pillar model with substantial tailoring to Hungarian conditions.

The Finance Ministry initially proposed a reform plan as radical as that of Kazakhstan, but it was quickly moderated due to internal disagreement within the government. The evolution of the Finance Ministry's proposal for fundamental reform is instructive, as it shows how reformers themselves may moderate reform proposals to anticipate opposition from alternative veto and proposal actors. Under the leadership of Adam Gere, an investment banker whose firm had a large share of the business managing Hungary's voluntary third-pillar funds, the Finance Ministry working group initially discussed a complete phase-out of Hungary's PAYG system (interview with Gere, May 5, 1998). A Hungarian émigré based in the United States, Gere took a technocratic, non-political approach to reform and quickly became almost as controversial a figure as Bokros himself. However, other members of the working group opposed Gere's efforts at fundamental reform on two grounds: finance and political feasibility. They argued that Hungary's high implicit pension debt would make it difficult to finance the transition and that it would be politically unfeasible to eliminate the PAYG system. A full transition to a Chilean-type system was regarded as "un-European" (cf. Palacios and Rocha 1998, 18) and unsaleable in a country with a strong tradition of PAYG pension provision.

After extensive debate, the Finance Ministry proposed a pension system that would be 50% pay-as-you-go and 50% funded (*Magyar Hirlap*, January 29, 1996). The proposal would have reduced total social sector contributions from 54% to 44%, with 25% earmarked for pension insurance and 19% for health. Within the 25% pension contribution, a 15% employer contribution would be applied to the first pillar and a 10% employee contribution to mandatory private funds. People aged 40 and under would be obliged to join the new system (*Napi Gazdasag*, December 2, 1995). Members of the working group who had initially been skeptical of fundamental reform, including the chairman of the supervisory board for the third-pillar pension system, supported it after it was decided that the organization of the second pillar funds would mirror those of the third pillar, and would be placed under the same regulatory authority (interview with Laszlo Urban, May 6, 1998).

TABLE 3. PENSION REFORM PROPOSALS IN HUNGARY, 1996

	Ministry of Finance	Pension Insurance Fund	Ministry of Welfare
goals of the reform	<ol style="list-style-type: none"> 1. reduce the role of the state; 2. make state guarantee partial; 3. increase self-reliance; 4. finance pension insurance without its posing burden on the budget; 5. decrease employer contributions. 	<ol style="list-style-type: none"> 1. ensure pensions proportional to the number of service years and amount of contributions paid; 2. wage indexation of benefits; 3. create the conditions for long-term stable financing of the system; 4. ensure the provision of pensions and consolidation in the short-term. 	<ol style="list-style-type: none"> 1. provide the aged with income security; 2. create system that is uniform, mandatory and rests on insurance principles.
Characteristics of model	<ol style="list-style-type: none"> 1. three-pillar system; 2. basic pension is PAYG, depends on income and service years, financed exclusively from employers' contribution; 3. second funded pillar financed from employees' contribution; 4. means-tested normative state pension; 5. voluntary funded third pillar 	<ol style="list-style-type: none"> 1. labor pension system with two complementary pillars; 2. universal basic pension amounting to 30% of the pensioners' income; 3. labor pension with less solidaristic elements ensuring 60% of old-age income, determined based on lifetime earnings using a point-system, its source is the employers' and employees' equal contribution rates; 4. voluntary pension funds providing 10% of pensioners' income 	<ol style="list-style-type: none"> 1. two-pillar pension system 2. PAYG Labor Pension: provision proportional to contributions paid determined on insurance principles; 3. contribution split evenly between the employers and employees; 4. 57-58% replacement rate, no minimal pensions; 5. voluntary pension funds as at present; 6. complementary state social assistance
type of financing	<ol style="list-style-type: none"> 1. contribution base is the same as the personal income taxable wage; 2. employers' burden significantly decreases while employees' significantly increases; 3. state budget expenditure increases as a result of the means-tested pensions; 4. pension system expenditures decrease 	<ol style="list-style-type: none"> 1. earmarked income tax reserved to finance the basic pension; 2. labor pension: employer and employee contribution; 3. budget's full guarantee remains unchanged; 4. leads to decreased contribution rates 	<ol style="list-style-type: none"> 1. PAYG Labor Pension contribution base is equivalent to the taxable wage income between min. and max. limits; 2. pensions are gross, thus become taxable
pacing of reform	<ol style="list-style-type: none"> 1. system starts immediately but only those under 40 have to join; 2. maturation takes 20-25 years 	<ol style="list-style-type: none"> 1. principles of the new pension system to be worked out by June 1996 and summarized in a parliamentary decree 	<ol style="list-style-type: none"> 1. new system can start in 1-2 years
period of transition	<ol style="list-style-type: none"> 1. widen contribution base in order to consolidate system in the long-run; 2. introduce minimum contribution base; 3. decrease employer contribution; 4. increase employee contribution; 5. increase retirement age to 65 by 2012; 6. price indexation of benefits 	<ol style="list-style-type: none"> 1. uniform retirement age; 2. linear pension scale; 3. continuation of valorization; 4. determining upper and lower limit of contribution base 5. decrease employer and employee contribution rates 	<ol style="list-style-type: none"> 1. make retirement age uniform, then raise retirement age; 2. restrict early retirement conditions; 3. point system to determine pensions; 4. do not count service years without contribution payment; 5. keep individual records.

SOURCES: *Magyar Hirlap*, "Secure Pensions, A Comparative Table of the Pension Reform Concepts of the MoF, MoW, and Pension Insurance Fund," April 5, 1996 and own observations.

During 1995 and early 1996, two other proposal actors in Hungary developed pension reform proposals, without the benefit of World Bank technical assistance,² and with a more conservative agenda. The Ministry of Welfare developed a competing proposal, assisted by German advisers. The Pension Insurance Fund (PIF) supervisory board, an elected body made up mainly of trade union representatives, developed a third proposal. However, the PIF was outside direct government control. This meant that the PIF was not a veto actor, but also that the government could not force the PIF to cease advocating its alternative plan, even as Hungary moved into the coalition-building stage. Deliberation within the government over these three proposals resulted in a deadlock that lasted through the beginning of 1996.

This deadlock was broken by a change in personnel at the Finance Ministry. Bokros resigned as Finance Minister in February 1996, leaving Gere's working group without its top political sponsor. While this could have weakened or changed the finance ministry's position, the new Finance Minister Peter Medgyessy remained equally committed to pension reform. However, he was more willing to compromise in order to reach agreement.

In early April 1996, the government committed itself to developing a unified pension reform proposal by the end of the month (*Nepszabadsag*, April 3, 1996). Pressure from international organizations seems to have played an important role in setting this deadline. Prime Minister Horn wanted credibility in the West for his Socialist Party, and Hungary had agreed with the IMF to develop a pension reform program by December 31, 1996. Hungary's electoral timetable also influenced this decision. New elections were scheduled in May 1998. The government therefore wanted to implement reform in January 1998, which did not leave much time.

Medgyessy invited representatives of the Ministries of Finance and Welfare to his office on April 9, 1996 and told them they had to agree on the outlines of a joint program. During the meeting, Minister of Welfare Gyorgy Szabo accepted a partly-funded system, if a way could be found to finance it (*Magyar Hirlap*, April 10, 1996; *Budapest Business Week*, April 15-21, 1996). A compromise was reached, in which the Ministry of Finance program became the main framework document, but the size of the second pillar was reduced from about one-half to one-third of total contributions. The point-system for reforming the first pillar was taken from the Ministry of Welfare program, along with a lower labor period to qualify for a first-pillar pension, 20 years, rather than the 32 or 35 proposed by the Ministry of Finance. The basic pension would be financed by an 18% employer contribution and the second pillar by a 10% employee contribution (*Magyar Hirlap*, April 24, 1996). The reformed system would produce an estimated average replacement rate of 55-60%.

One proposal actor, the Pension Insurance Fund (PIF), remained outside of this government compromise. Minister Szabo wanted to find a way to get the PIF to agree, at least in principle, with the outlines of reform. However, this proved impossible. Instead, with the main veto/proposal actors agreed on the outlines of reform, the government decided to move ahead, wanting to implement reform before the end of the parliamentary term. Multiple veto and proposal actors forced government reformers to compromise on their reform designs. They also caused delays, but ultimately an agreement

² The Pension Insurance Fund did not have World Bank support to develop pension reform proposals, but it did have access to another World Bank technical assistance loan (PAHIP) that it may have drawn on to develop and promote its proposal.

was reached. The Ministry of Finance, backed by World Bank resources, emerged from the commitment-building process with the main lines of its reform proposal intact, and a government commitment to establish a mandatory, funded pillar in Hungary.

5.2.3 COALITION-BUILDING

	Proposal actor	Veto actor
Working group	x	x
Prime Minister/Socialist Party		x
Alliance of Free Democrats		x
Trade Unions/IRC		x
Pension Insurance Fund	x	
Total	2	4

The April 1996 reconciliation of the two government programs started a new phase in the development of reform. Coalition-building in Hungary was mainly a process of working out differences within the government coalition itself, which held 72% of seats in parliament. The two partisan veto actors were the Socialist Party and the Alliance of Free Democrats, a liberal party that was favorably predisposed to fundamental reform. The Socialist Party was divided. Because of these divisions, the voice of the Socialist-affiliated trade unions (MSZOSZ) became highly influential. Some Socialist parliamentarians refused to vote for fundamental reform unless it was first approved by the Interest Reconciliation Council (IRC), in which the Socialist trade unions had a decisive voice. This shifted deliberation from the parliament to the IRC. Discussions in the IRC took longer, and produced more compromises, than those in parliament. Negotiations in the coalition-building stage in Hungary caused some watering-down of reform proposals, among other things reducing the contribution rate to the second pillar from 10% to 6-8%. This reflected divisions among the four main veto actors, and the presence of an alternative proposal actor, still advocating rationalization of the existing PAYG system, rather than fundamental reform.

During the coalition-building stage, the main proposal actor was the interministerial working group for pension reform, where government reform proposals were elaborated and legislation drafted. The World Bank was heavily involved in funding and assisting the new interministerial working group. Several World Bank representatives participated in the 30-member working group as observers, and provided much of its technical capacity. However, membership of the working group was cast fairly widely. Experts from the Ministry of Welfare were included, helping to prepare changes in the first pillar. A prominent investment banker, Csaba Lantos, was chosen to head the 'investment team' charged with drawing up portfolio management rules and principles related to the introduction of the funded pension system (Pension Team, 30 May 1996).

Handling opposition from the alternative proposal actor, the Pension Insurance Fund, was a key concern of the government. In July 1996, Minister of Welfare Gyorgy Szabo and State Secretary Tibor Draskovics of the Ministry of Finance wrote that the PIF had to be involved in the reform process, in

order to help with necessary data collection and eventual implementation (Ministry of Welfare, July 1996). However, the government working group continued its work without participation from PIF experts. The distance between the two proposals was too great to allow for meaningful collaboration. Interestingly, the PIF also had access to a World Bank loan that had been processed earlier and used the technical assistance component of this loan to conduct its own reform agenda.

World Bank assistance to the working group intensified, allowing the employment of numerous foreign experts. By December 1996, the working group had created models of the new pension system, with flexible parameters and a highly detailed legislative proposal, consulted with a variety of national and international legal experts. Moreover, the working group dominated expert debate within the country, with cohesive argumentation in a number of important expert and public fora (interview with Roberto Rocha, May 6, 1998).

A special parliamentary group became the main forum for ironing out differences between the two partisan veto actors. The Coalition Parties' Working Group on General Government Reform was founded by reformers from the Hungarian Socialist Party and the Alliance of Free Democrats towards the end of the Bokros period, and dedicated to pushing a liberal reform agenda. Powerful centrist members of the Hungarian Socialist Party also joined the group, including Sandor Nagy and Judit Csehak, key figures in social policymaking (interview with Klara Ungar, August 1998). The coalition parties' working group had initially been undecided about fundamental reform. In early April, it began to lean towards supporting the Ministry of Finance proposal (*Nepszabadsag*, April 3, 1996).

On April 23, 1996, after the forced reconciliation of the Ministry of Finance and Ministry of Welfare proposals, the Coalition Parties Working Group on General Government Reform formally considered the joint proposal of the government, and after extensive discussions, lent its full support to the program. These deliberations proved crucial, since several parliamentarians with important roles in social policy committees had to be convinced of the wisdom of the government plan. One key player who came over to the government side was Judit Csehak, chair of the social policy committee in parliament, and a former welfare minister under communist rule. She would play a critical role in forging compromises she judged acceptable to parliament, and later in selling the program to a wider audience. It should be noted that Csehak, like other major players in the pension reform debate in Hungary, was also involved in setting up third-pillar voluntary mutual benefit societies, and thus had business interests in the sector. Csehak reportedly fought for higher annuity rates in the second pillar and more guarantees, especially of a minimum annuity from the second pillar. She had strong views on the role of fund managers and was conscious of public acceptability of the program (interview with Tibor Parniczky, May 7, 1998). The coalition parties' working group replaced, to a certain extent, deliberation within parliament itself, creating a level of agreement among coalition parliamentarians that obviated the need for extensive deliberation later on.

Parliament also held several debates that allowed room for broader public discussion outside the main partisan veto actors. The first was on May 8, 1996, the day before the government approved the joint concept of the Ministry of Finance and Ministry of Welfare. Parliament considered a draft of the government's proposal in July and held another debate day on October 13, 1996, called for by the Hungarian Democratic Peoples' Party (MDNP). This enabled parties to repeat their already clear

positions on pension reform program (*Magyar Hirlap*, October 14, 1996). But by this time, a critical mass of coalition parliamentarians supported the reform (interview with Roberto Rocha, May 6, 1998).

Interestingly, the leading right opposition party, the Young Democrats (FIDESZ), was split over the government's pension reform program. While some deputies spoke out against the reform, others stayed quiet during the pension reform process. These reformers did not want to urge more radical changes, such as a further increases in the pension age, which they feared would be unpopular. On the other hand, they did not want to object to the fundamental precepts of the program, for fear of wrecking a reform which some within FIDESZ saw as desirable (interview with Laszlo Urban, May 6, 1998). The position of the main opposition party became important during the implementation phase as FIDESZ, after winning the 1998 elections in Hungary, enacted several important modifications to the reformed pension system. Had this potential veto actor been possible to include earlier in the reform process, it might have limited the scope of post-hoc adjustments.

Once the working group had finished its legislative drafting and modeling, winning the support of the key partisan veto actors, it set out at the beginning of 1997 to engage in a broad public discussion intended to rally diffuse support for reform and bring skeptical interest groups on board. A public relations campaign was launched and an intensive series of meetings was organized with different interest groups and top officials from the working group. Minister of Finance Peter Medgyessy was prominent in many meetings, along with working group leaders Istvan Gyorffy and Maria Major. World Bank advisers chose to not take an active role in public discourse, to avoid the perception that the reform was foisted upon Hungary by the World Bank (interview with Roberto Rocha, May 6, 1998). This partial list of meetings between working group members and various social groups, compiled from Ministry of Finance documents, indicates where the government saw potential interest group opposition and significant actors in the debate:

Meetings on Pension Reform, 1997

January 6: Coalition parties
January 7: Pension Insurance Fund
January 8: Parliamentary representatives
January 14: National Alliance of Pensioners
January 15: Council of the Elderly
January 21: Child and Youth Interest Reconciliation Council
January 22: Board of Directors of SZEF state and municipal employees' trade union
January 29: Board of Directors of MSZOSZ trade union
January 30: Hungarian Socialist Party members of parliament
February 4: Interest Reconciliation Council
February 7: Interest Reconciliation Council
February 13: Conference organized by Sandor Nagy (former head of MSZOSZ and PIF)
February 17: Hungarian Democratic Peoples' Party (MDNP)
February 19: Hungarian Socialist Party Left Group
February 21: Board of Directors of SZEF trade union
February 26: MSZOSZ Council of Alliance leaders (including PIF President Janos Vago)
February 28: Interest Reconciliation Council
March (various dates): Hungarian Socialist Party MPs
 Hungarian Socialist Party Board of Directors
 Alliance of Free Democrats (SZDSZ) MPs
March 11: Pension Insurance Fund
March 12: Interest Reconciliation Council

The most powerful interest group was the Socialist-affiliated trade union federation, MSZOSZ, which was represented both in the Pension Insurance Fund board and within the Socialist party parliamentary group itself. However, the socialist trade unions also had their own independent base of support, and a credible strike threat. MSZOSZ also dominated the Pension Insurance Fund board, and thus had a significant stake in the pre-reform system. The main forum for reaching an agreement with the trade unions was Hungary's Interest Reconciliation Council (IRC), a tripartite body bringing together representatives of government, labor, and business for regular meetings on economic and social policy issues.

In the first of a series of IRC meetings on February 4, 1997, the government proposal met with fierce resistance from the MSZOSZ trade union leadership. Some trade union representatives supported the Pension Insurance Fund plan for a reformed PAYG system, and at the start of negotiations, MSZOSZ trade union leader Laszlo Sandor expressed opposition to channeling one-third of payroll tax contributions to a mandatory funded pillar. Employer representatives questioned the mandatory funded pillar as well, on the basis of transition finance. Finance Minister Medgyessy tried to counter these arguments by focusing on the time pressure reformers were under, arguing that pension reform had to happen in 1998, before the upcoming elections (*Nepszabadsag*, February 5, 1997).

A key sticking point was the half-price, half-wage pension indexation (called “Swiss” indexation) of pensions proposed in the government bill. Other issues included whether to adopt the first-pillar point system proposed by the PIF, whether years spent raising children and studying at universities should count as service years, and the benefit formula used in the first pillar (*Vilaggazdasag*, February 10, 1997). The two sides were so far apart that MSZOSZ leader Laszlo Sandor announced that he would lead the workers out on strike if the government submitted its original proposal to parliament (*Napi Gazdasag*, February 8, 1997).

However, a number of significant compromises were reached in the Interest Reconciliation Council. The government agreed to a more generous benefit formula for the first pillar, to create a state guarantee for the second pillar funds, and to allow people the option of paying into the private pillar during years spent in child-raising or studying at universities, and to count these as service years that qualify for minimum benefits. The transition to Swiss indexation was delayed until 2000, and in the meantime the government agreed to several above-inflation adjustments to pension rates (*Magyar Hirlap*, February 13, 1997).

Further compromises were made at a conference on February 13 organized by Sandor Nagy, a former head of both MSZOSZ and the Pension Insurance Fund. Nagy criticized the government for not paying more attention to the PIF proposal, and yet worked out a deal that would allow multi-pillar reform to go ahead. While the government had been proposing a 10% contribution to the mandatory private pillar, and trade unions wanted 3%, a compromise was reached whereby the initial contribution rate would be 6%, phased up to 8% in two years (interview with Klara Ungar, August 1998; interview with Roberto Rocha, May 6, 1998, interview with Mihaly Kokeny, August 1998). Other compromises reached in February 1997 IRC meetings included increased state guarantees for the second pillar, changes in the rates for crediting years worked under the mixed system, additional maternity years counted towards pension eligibility, and a two-year waiting period before special occupation groups'

retirement conditions were re-regulated (Ministry of Finance documents, February-March 1997). Thus trade unions had a moderate, but significant impact on reform. Their effectiveness was determined by their strong links with Socialist Party leaders like Nagy, and their presence within the both Socialist Party parliamentary group and the PIF.

Palacios and Rocha estimated the value of the most important compromises made during this period of public dialogue (1998, 31), including the delay in implementation of Swiss indexation and an increase in survivors' benefits. They found that these two changes alone would cost between 0.5 to 1.0% of GDP during the first decade or so of transition, making the total savings in implicit pension debt 15% less than previously. However, Palacios and Rocha also found that the impact of these changes would diminish substantially over the long run. They concluded that "the political compromises focused on the very short term and that the discount rate for political calculations was high." This suggests the broad feasibility of making acceptable short-term political deals in order to lock in fundamental reform over the long term.

Despite these agreements in February, resistance from the Pension Insurance Fund and the trade unions continued until the end of April 1997, when pressure for an agreement intensified as the government prepared to submit its proposal to parliament at the beginning of May. The Interest Reconciliation Council (IRC) reached a final agreement in its last scheduled session (*Magyar Hirlap*, April 30, 1997). This reflected two additional compromises, one that postponed reform of the disability pension system (interview with Mihaly Kokeny, August 1998), and a second that should have perpetuated Socialist-affiliated trade union dominance of the Pension Insurance Fund by delegating seats according to a pre-set formula that favored the MSZOSZ. In addition, the PIF was promised that it could found its own second-pillar fund (interview with Gabor Futo, August 25, 1998) and some suggest that the leader of the MSZOSZ trade union, Laszlo Sandor, was promised a prominent place on the Socialist Party's electoral list and appointment as Minister of Labor after the 1998 elections (interview with Laszlo Keller, August 25, 1998).

Parliament had made IRC approval a precondition for passing the program into law, and when the social partners were satisfied, parliament moved swiftly. On May 12, almost exactly a year after the first parliamentary debate day, the government submitted its pension reform plan (*Nepszabadsag*, May 13, 1997). It consisted of five laws and two parliamentary decree proposals. The government pushed for the package to be voted on immediately by parliament, after two weeks of study, but the opposition refused. Deputies complained that the laws were drafted in a very opaque fashion, and working group head Istvan Gyorffy agreed, but blamed it on the PIF (*Nepszabadsag*, May 23, 1997). Parliamentary debate began on June 3 and continued until July 15, with the opposition voicing doubts over financing the transitional pension deficit, and whether private pension funds would really bring much benefit to the economy (*Nepszabadsag*, June 11 & July 16, 1997). The five laws were passed on July 15, 1997, with support from 55-58% of deputies (Ferge 1997, 13).

A number of observers have criticized the closed and elite nature of the policy process in Hungary that led up to the acceptance of pension reform legislation in July 1997 (cf. Ferge 1997, 13). There is no question that the process was mainly one that took place within the government coalition, with some consultation with interest groups connected with the Socialist Party. World Bank and other experts played a leading role as consultants to the working group, while discussions in the Interest

Reconciliation Council produced only a moderate level of compromise on the parameters of reform. Public discussion was taken into account only towards the end of the process, during a time when the government's priority was to 'sell' the reform through a concurrent public relations campaign. Yet, the main partisan veto actors themselves contained a fairly wide range of interest groups. Coalition debate was fairly open, and allowed for a wide range of expert views to be expressed. Opponents of the original Ministry of Finance proposal within the government coalition had to be won over, and eventually a wide cross-section of experts were included in the inter-ministerial working group. Opinions of the Pension Insurance Fund were not accepted in whole, but some compromises with it were reached. The PIF could have rallied support in parliament, but it did not. In sum, while pension reform in Hungary was indeed an expert or elite process, it was also a relatively open and democratic one of deliberation within a super-majority government coalition. Hungarians are now voting with their feet and choosing to participate in the new, mixed system. Whatever the valid criticisms, the policy process in Hungary has produced a reform that has gained the confidence of a wide cross-section of the population, which is one measure of substantive democratic results.

Hungary's reformed pension system started operations on January 1, 1998. Since then, new labor force entrants have been required to participate in the new, mixed system. Other workers were given a choice whether to switch. However, guarantees within the new system are provided only for those with 15 years of contribution at retirement, which encourages workers over the age of 47 not to join (Palacios and Rocha 1998, 21). In addition to implementing a mandatory, funded pillar, the reform also significantly altered the PAYG first pillar, phasing in a higher retirement age of 62 for both men and women by 2009, Swiss indexation (a 50-50 price-wage mix) of benefits by 2001, and a new benefit formula and tax regime by 2013 (Palacios and Rocha 1998, 22). The first pillar remains PAYG, funded by a payroll tax of 30% of gross wages for those remaining in the old system, or 22% for those joining the mixed system.

5.2.4 IMPLEMENTATION

One striking feature of the Hungarian reform is the extent of changes it underwent in the early implementation phase, due to a new partisan veto actor entering the process. When the center-right party, FIDESZ, unexpectedly won elections in May 1998 and formed a government, it shelved plans to increase the contribution rate to the second pillar from 6% to 8% over a two-year period, as agreed in the Interest Reconciliation Council (IRC). It also eliminated the quasi-independent Pension Insurance Fund, bringing pension system administration under direct government control and destroying an important power base of the leftist trade unions. The new government further eliminated the Ministry of Labor and refused to implement generous percentage increases in pension benefit levels agreed with the trade unions in the IRC. While reform was not completely reversed, the FIDESZ government significantly reduced the size of the private, funded pillar, angered private pension fund companies, and destabilized some of the political compromises that had made pension reform possible in the first place (interview with Sandor Nagy, August 1998).

These changes demonstrate the power that new actors may have when they rise to power in the implementation phase. They also underline some of the tradeoffs that reformers face across phases of reform and deliberative fora. Excluding FIDESZ from deliberation in the early stages of reform

simplified commitment- and coalition-building. Since the government had 72% of seats in parliament, there was no need to negotiate with partisan actors and interest groups outside the government coalition. Using the coalition parties' working group as a deliberative forum, rather than a regular parliamentary committee, also simplified the process, but at the cost of alienating potential supporters from opposition parties. When excluded partisan actors suddenly rose to power, they substantially revised the new system. Still, despite moderate reversals, Hungary became the first country in postcommunist Central Europe to implement fundamental pension reform.

5.2.5 CONCLUSIONS

As predicted in the first hypothesis, Hungary shows that policy legacies do have a major impact on pension reform design. Hungary's high implicit pension debt played a role in limiting the relative size of the private pillar to about one-quarter of total contributions. Similarly, the policy legacies of third-pillar reform in 1993 influenced the shape of the second pillar. Representatives of the third pillar funds and regulatory agency, including key members of the Hungarian Socialist Party, lobbied successfully to make the design of the second pillar match that of the third, and to extend the powers of the third-pillar agency to regulate it.

As expressed in the second hypothesis, the involvement of multiple veto and proposal actors also had a powerful influence on reform. The need to compromise among veto actors within the government about the basic design of reform clearly limited the degree of change, reducing the size of the private pillar. Negotiations between the government and trade union interest groups resulted in a further reduction in the size of the private pillar. Hungary's Pension Insurance Fund shows that proposal actors, even when they do not exercise veto power, can influence outcomes of reform. Pension Insurance Fund opposition to a funded pillar bolstered the position of anti-reform trade unionists and increased the cost of compromise in the Interest Reconciliation Council. This also provides evidence for hypothesis three, that the impact of interest groups is linked to their associations with major veto and proposal actors. Through their close association with both major proposal actors, trade unions were able to substantially reduce the size of the new private pillar and gain other concessions, while groups not affiliated with key veto or proposal actors were excluded from the policy process.

The fourth hypothesis suggested that direct World Bank intervention and ideas would have a major influence on the extent of policy change. While the World Bank did contribute greatly to reform in Hungary, it is notable that while the Bank was involved earlier and more heavily in Hungary than in Kazakhstan, Kazakhstan that produced a reform with a larger private pillar. Greater World Bank technical assistance does not produce a larger private, funded pillar. Two factors seem to explain this. First, the World Bank does not always advocate a larger funded pillar and gives a variety of options within the multipillar system. While *Averting the Old Age Crisis* was an influential work, disagreements persist within the World Bank on the best type of pension reform for a given country, and *Averting* itself offers a range of possible solutions. There is also widespread support within the World Bank for solutions such as "notional defined contribution" systems (discussed below) that are not advocated in *Averting*. What advice the World Bank gives depends a great deal on the actual consultants employed in a given country, their ideas, experiences, and predispositions (Deacon 1997). Second, the World Bank is not the only source of pension reform ideas. In the case of Kazakhstan, USAID was

particularly influential, and pushed for a more radical variant of reform than some World Bank officials might have preferred. This suggests that World Bank influence depends on its relations to key veto and proposal actors. When it gives advice to a single, dominant proposal actor, the World Bank can be extraordinarily effective. However, when multiple proposal actors are involved in the policy process, the World Bank can only advocate its position in government fora, support a chosen proposal actor through technical assistance, and accept final outcomes of reform that depend on domestic political processes. One clear commonality is that the World Bank will generally support reforms that have some funded component, but this may come in a wide variety of forms. However, even this general commitment to privatization is not monolithic. The Bank also supports pension reforms that have no private, funded component (for instance in Moldova, see Cashu 1999), under certain circumstances and local conditions.

Two final hypotheses concern tradeoffs across deliberative fora and phases of reform. How did these play out in Hungary? Tradeoffs across deliberative fora were evident in the intense negotiation of reforms in Hungary's Interest Reconciliation Council and special coalition parties' working group, rather than in parliament. Negotiations in these two fora significantly reduced the need for extensive deliberation in parliament, since the major veto and proposal actors and interest groups had already been consulted.

Tradeoffs across policy stages are also visible in the Hungarian case. Hungary moved ahead with reform in April 1996 by forcing reconciliation between two governmental proposals for reform, but leaving the Pension Insurance Fund (PIF) out. This involved a tradeoff across phases. Exclusion of the PIF at the commitment-building phase increased the speed and radical nature of reform design. However, it also appears to have increased the costs of compromise at the coalition-building phase. The presence of an alternative, non-governmental proposal actor lent weight to trade union opposition to reform. In another tradeoff in the coalition-building phase, reformers decided to rely solely on the government coalition's super-majority in parliament to pass reform, without support from opposition parties. This speeded reform and avoided potential compromises, but had costs in implementation. For when opposition parties took power after elections in May 1998, they reduced the size of the private pillar and revoked some of the compromises that had been made by the government in the IRC. Including opposition parties in coalition-building may have watered down reform, but also may have avoided post-hoc reductions in the private pillar during implementation.

In the next section, we will see that Poland provides a striking example of reform being negotiated across political boundaries of government and opposition, enhancing the durability of political compromises reached on the design of reform.

5.3 POLAND

5.3.1 POLICY LEGACIES

In the mid-1990s, Poland's pension system suffered from transition policies that drastically expanded eligibility for early retirement and disability pensions, causing a rapid rise in the system dependency ratio. As opposed to most postcommunist countries, average replacement rates (as a

percentage of pre-retirement income) also increased, from about 60% to about 75% between 1990 and 1993 (Andrews and Rashid 1996, 9). Both of these trends caused pension spending to skyrocket. Pension spending in Poland ranked among the highest of any postcommunist transition country in 1993, despite Poland's relatively favorable demographic situation (Andrews and Rashid 1996). Poland also inherited a widespread system of special pension privileges, a history of ad hoc changes in indexation rates, and an emerging demographic problem. Poland's implicit pension debt was 220% of GDP at the outset of reform (James 1998b), while payroll tax contribution rates for all forms of social insurance reached 45%. The pay-as-you-go state pension system was managed by a special pension insurance institution, ZUS. A special farmers' pension system, KRUS, was heavily indebted and kept afloat by government subsidies.

As early as 1991, ZUS president Wojciech Topinski and Marian Wisniewski (1991) proposed a partially-funded pension system for Poland. However, while this proposal had a strong impact in some expert circles, it was never debated as a government program. Pension reform was perceived by politicians as an issue that was too controversial to tackle, and there was little agreement on the substance of reform.

Instead, as pension spending increased from 8.6% to 15.5% of GDP between 1990 and 1994, Polish governments used ad hoc measures to control spending by changing benefit formulae, indexation levels and rules on additional allowances. Poland's Constitutional Tribunal put an end to these practices by issuing decisions that declared ad hoc changes illegal and forced the government to repay any lost benefits. Only then did government officials take the pension crisis seriously, and begin to work toward comprehensive reform. (Chlon et al. 1999, 12; Hausner 1998, 14).

5.3.2 COMMITMENT-BUILDING

	Proposal actor	Veto actor
Ministry of Finance	x	x
Ministry of Labor and Social Affairs	x	x
Prime Minister/Democratic Left Alliance		x
Polish Peasant Party		x
Solidarity Trade Union	x	
Institute of Labor and Social Affairs	x	
Total	4	4

When Poland began to consider fundamental reform in 1994, four distinct proposals were elaborated. The proposals of the Ministry of Finance and Ministry of Welfare were by far the most important; however, it is notable in Poland that two civil society actors formulated their own proposals. A proposal by the Solidarity trade union was seriously debated, while a proposal by and the Institute of Labor and Social Policy had a minimal impact. Still, the presence of alternative civil society proposal

actors sets Poland apart from Kazakhstan and even Hungary, indicating a higher level of public involvement in the pension reform process.

However, the main forum of the pension reform debate remained the government, and the central feature of the commitment-building stage in Poland was a year-and-a-half long standoff (late 1994 to mid-1996) between the Ministry of Finance and the Ministry of Labor and Social Affairs over opposing proposals for reform (Chlon et al. 1999, 12). While Finance Minister Grzegorz W. Kolodko made a general proposal for fundamental reform of the pension system in his June 1994 "Strategy for Poland," Minister of Labor and Social Affairs Leszek Miller wanted to rationalize the existing system. This polarization of reform proposals within the government set the stage for a long debate. Since Miller was an important figure within the governing Alliance of the Democratic Left (SLD), while Kolodko was an independent economic expert, Miller initially had upper hand within the government. The government initially approved the Ministry of Labor's proposals for rationalization in May 1995, which provided for:

- establishing a basic pension of 30% of average wage for everyone;
- an additional insurance-based pension for all those who had contributed to the system more than 15 years, proportional to an individual's earnings and work period;
- supplementary pensions based on voluntary contributions;
- equalizing indexation rules for the uniformed services;
- limiting and partially eliminating branch privileges;
- gradually increasing the contribution rate to the farmers' pension system;
- capping contribution rates at 250% of average wage;
- splitting contributions equally between employees and employers;
- introducing more restrictive rules for disability qualification;
- gradually increasing the retirement age to 65 for both men and women.

The Ministry of Finance strongly opposed the Ministry of Labor's program as being too conservative and quickly formulated an alternative proposal for a Chilean-type reform. It was conceived by Marek Mazur, an advisor to Minister Kolodko. Mazur made a study trip to Latin America and supported a dominant funded pillar. Extensive public opinion research also showed that Poles found the Ministry of Labor's proposal too timid and wanted more radical reform. In the autumn of 1995, the government changed course and recommended the preparation of a version of pension reform program that would give a greater role to a funded pillar (Hausner 1998, 15-16). Now on the defensive, the Ministry of Labor played a blocking role and the reform process remained at a standstill.

In January 1996, the Institute of Labor and Social Affairs convened an expert conference to discuss and reconcile the competing governmental and non-governmental proposals. The main principles of each concept are presented in Table 4, with the Ministry of Labor and Ministry of Finance proposals on the two extremes, and the ones formulated by non-governmental organizations situated between these two. The conference ended with a recognition that each of the programs had its flaws, and that a new approach was needed.

An end to the stalemate finally came in February 1996. As a result of a cabinet reshuffle, and the appointment of a new Prime Minister, Włodzimierz Cimoszewicz, Labor Minister Miller was

transferred to the Interior Ministry, while Andrzej Baczkowski was appointed Labor Minister in his place. Both the new Prime Minister and Labor Minister supported fundamental reform. Baczkowski also had been a Solidarity activist, and thus provided a link between the left government and the main opposition proposal actor, the Solidarity trade union. Baczkowski had demonstrated unusual negotiating skills and had been appointed chairman of the new tripartite commission for socio-economic affairs in 1994.

Baczkowski proposed creating a special office for pension reform, called the Office of the Plenipotentiary for Social Security Reform, that would improve coordination within the government, render pension reform independent of any ministry, allow non-governmental experts to be involved in the drafting, and indicate government commitment to fundamental reform (Chlon et al. 1999, 13). Baczkowski was appointed Plenipotentiary as well as Labor Minister, taking overall political responsibility for the reform. The World Bank was asked to assist in the creation and funding of the office of the plenipotentiary, which it did. A Polish World Bank official, Michal Rutkowski, was appointed head of the office of the plenipotentiary, taking responsibility for the day-to-day running of its activities, and the drafting of reform proposals.

Establishment of the Plenipotentiary and the Office of the Plenipotentiary marked a major breakthrough in the pension reform effort in Poland. The appointment of a pro-reform prime minister, the reassignment of Minister Miller and the creation of a single governmental office for pension reform reduced the number of veto actors within the government, indicated strong commitment to reform, and allowed the process of technical drafting to move swiftly ahead. The numerous proposal and veto actors involved, and the long delay in reaching government commitment to fundamental reform meant that Polish reformers had to race against the electoral clock, with parliamentary elections scheduled for September 1997. Unanticipated events and further government shake-ups meant that Poland could not pass the whole legislative package for pension reform in one parliamentary cycle. Poland's coalition-building process therefore was divided into two distinct phases.

5.3.3 COALITION-BUILDING: PHASE ONE

	Proposal actor	Veto actor
Office of the Plenipotentiary	x	x
Prime Minister/Democratic Left Alliance		x
Parliament		x
Solidarity trade union	x	
Total	2	3

Poland is the only country in our sample in which pension reform was passed by two successive governments and parliaments, representing most major parties at one time or another. The first phase of coalition-building lasted from April 1996 to August 1997, and resulted in the passage of three pieces of legislation that regulated the organization of the new second and third pillars, and the use of privatization revenues to finance the transition. The second phase lasted from September 1997 to December 1998,

under a new center-right government, which approved laws overhauling the first pillar and withdrawing special pension privileges. Support of partisan actors across the political spectrum is particular to Poland, and the manner in which it was achieved is instructive for other democratic countries contemplating reform.

Work on the new pension program, *Security through Diversity*, began in September 1996 and was completed in February 1997, three months after the shocking, sudden death of Andrzej Baczkowski in November 1996. The loss of Baczkowski's great personal force endangered the progress of reform. Baczkowski's successor at the Labor Ministry, Tadeusz Zielinski, was skeptical of fundamental reform. However, the OP persevered with continued prime ministerial support. The government appointed Jerzy Hausner, a former adviser to Finance Minister Kolodko, Plenipotentiary for Social Security Reform and moved the whole OP structure to the Council of Ministers, where Hausner was Secretary of State.

During legislative drafting, the OP engaged in deliberation within the government on a wide spectrum of issues (see Hausner 1998, 21-23). The Ministry of Finance was involved in discussing methods of financing the transition to a funded system and the use of privatization revenues. The State Treasury was consulted on privatization-related issues. In contrast to Hungary, Poland's Social Insurance Institution (ZUS), the institution that manages the pension system, did not oppose a multi-pillar reform. This was partly attributable to institutional reasons, and partly to its leadership politics. Reform plans in Poland gave ZUS a substantial, new role as clearinghouse for all pension payments, administrator of the pay-as-you-go pillar, and the manager of a new system of individual insurance records (Hausner 1998, 22). Therefore, ZUS was not as threatened institutionally by reform plans in Poland as the Pension Insurance Fund was in Hungary. The ZUS President was also a political appointee, whereas the Pension Insurance Fund in Hungary was an independently-elected body with substantial trade union representation and intransigent leadership. Since it more or less went along with reform, ZUS It was consulted on administrative matters, although it also did not prepare sufficiently for a reform that would transform its own work significantly.

TABLE 4. BASIC ELEMENTS OF THE PENSION REFORM DISCUSSION IN POLAND PRIOR TO FORMULATING THE FINAL REFORM PROPOSAL

	Reform proposals formulated between autumn 1995 and spring 1996			
	Ministry of Finance	Solidarity	Institute of Labor and Social Affairs	Ministry of Labor
Basic pension – first pillar	Flat pension on the level of 20% of average wage	Basic pension consisting of two element – constant element financed from taxes and insurance element financed from contribution (individually determined)	Benefit dependent on the length of contributing and size of contribution. Contribution is financed by employee and employer with cap on contributions and pensions (gradually going to the level of average wage)	Benefit based on the length of working career and individual's salary, financed from contributions and state subsidies with a cap of 250% of average wage (going down to 200% of average wage)
Additional pension – second pillar	Mandatory saving in pension funds.	Mandatory saving in pension funds via shifting a part of social security contribution plus privatization bonds, given to all employees.	Voluntary savings in pension funds by people earning more than average salary. Additional system integrated with basic one and combined with tax preferences.	Voluntary savings in pension funds for people with highest income. Expected participation – marginal
Transition path	Mandatory participation for the new entrants, a choice between systems for employed, very high transition costs	Expected transition period for forming pension funds (c.a. 10 years), social security contribution divided between PAYG and funded pillars, significant subsidies from the state budget	Change in the first pillar at the start of the process. Lower replacement rate in the pension system introduced when first pensioners buy pensions in the second pillar. Transition costs covered by lower expenditures from the first pillar	Beginning of the legislation process by the end of 90s, implementation in the first decade of the next century. No proposals towards reduction of the costs of the basic system.

Source: *Gospodarka i Przyszłość*, special edition on Social Security.

The Office of the Plenipotentiary's *Security through Diversity* program was tacitly approved by the government in March-April 1997 as an amendment to its previously introduced plans. According to the program, the new pension system would be multi-pillar, with a large, but reformed, PAYG pillar, a new private pillar funded by approximately one-third of the old-age payroll contribution, and a reformed, voluntary, third pillar. The transformed first pillar would be based on a Notional Defined Contribution (NDC) system. While remaining PAYG, an NDC system translates individual contributions into "notional capital" that is placed "on deposit" in individual accounts. These accounts accrue "interest" at a set rate, and pay benefits that are closely linked to individual contributions. However, the money is not really on deposit, and the NDC is not really a funded system, as current contributions are used to pay current benefits. NDC does, however, achieve many of the objectives of a funded system, including making benefits transparent, linking them tightly to contributions, and introducing individual responsibility. *Security through Diversity* proposed a mandatory, private, funded second pillar, based on real defined contributions. It also called for a comprehensive reform of Poland's voluntary pension savings. For political reasons, as in other reforms, people above the age of 50 would not participate in the new system. Younger workers, below 30 years of age, would be required to join the second pillar, while those between 30 and 50 would have a right to choose whether to switch to the multi-pillar system or be covered only by NDC first pillar.

Security through Diversity won general support from Poland's Tripartite Commission in April 1997, including representatives of business associations and trade unions. Why did trade unions support fundamental reform in Poland, when they opposed it in Hungary? The answer has to do with the content of the Solidarity trade union's own proposal for reform, that was not too distant from the government proposal itself, and also called for the establishment of a private, funded pillar. However, the former communist trade union federation also supported a private pillar, while defending the primacy of the PAYG system. Although neither of these trade unions were formal veto actors, their voices were critical to attaining the high degree of parliamentary and public support garnered both on the government and opposition sides.

In order to move ahead with reform before elections in September 1997, the government decided to focus on passing the least controversial elements of reform, meanwhile tying Poland to a timeline that would force the next government to pass reform by the middle of 1998, and to start implementation in 1999. Between June and August 1997, the first set of implementing legislation was passed, on regulating and organizing the second and third pillars, and on the use of privatization revenues to finance the transition. The second-pillar law provided for the establishment of a pension fund regulatory agency (UNFE) in May 1998, a licensing process for private pension funds to start in August 1998, and pension funds to begin operations in January 1999. This created powerful constituencies that would force the next government to complete reform legislation. ZUS also awarded an expensive contract to a Polish company, Prokom, to develop a computer system to manage the new pension system. This reform legislation passed in parliament with support from 90 percent of deputies, and across the political spectrum (Hausner 1998, 31). Only a few right-wing deputies connected with the Christian national wing of the Solidarity movement voted against fundamental reform. Otherwise, all the major current and potential partisan veto actors supported reform. This proved important when the center-left coalition was overturned after elections in September 1997 by a new center-right coalition of

the Solidarity Electoral Action (AWS) and Freedom Union (UW), initiating a second phase of the coalition-building process.

5.3.4 COALITION-BUILDING: PHASE TWO

	Proposal actor	Veto actor
Office of the Plenipotentiary	x	x
Solidarity Electoral Action	x	x
Freedom Union		x
Total	2	3

While both center-right parties broadly supported fundamental reform, the change of government disrupted the coalition-building process in Poland, delaying further legislation until the new government recommitted to the specific reform ideas contained in *Security through Diversity*. Solidarity Electoral Action still supported the original Solidarity trade union proposal for reform, and in particular wanted the government to reconsider how to use privatization revenues to finance the pension system, a key aspect of the Solidarity proposal. Freedom Union support for *Security through Diversity* was less problematic, since a number of Freedom Union-affiliated experts served on the OP team. Still, it took a while to appoint a new government plenipotentiary, which slowed the process of legislative drafting. Civil society interest groups began increasingly to mobilize against reform, particularly the influential Federation of Trade Unions of Polish State Railway Employees, which opposed folding the railway workers' pension system into the general one. Meanwhile, the broad political consensus that led to the overwhelming passage of the first set of legislation began to break down (cf. Hausner 1998, 37-38). The new government refused to work directly with the outgoing Alliance of the Democratic Left (SLD). Former Labor Minister Miller was elected to lead the SLD parliamentary caucus in opposition and, having never supported fundamental reform, tried to mobilize the party against it. Work on the new information technology system for ZUS also slowed down, eventually causing a delay in the launch of the second pillar until April 1999.

Despite these problems, the coalition agreement signed by Solidarity Electoral Action and Freedom Union in November 1997 recommitted the government to pension reform as part of an aggressive package of four major reforms, including pensions, health-care, education and local administration. A new minister was appointed to coordinate the social sector reforms, Teresa Kaminska of Solidarity Electoral Action (AWS). Ewa Lewicka of AWS was appointed Plenipotentiary for Social Security Reform as well as a Secretary of State in the Ministry of Labor. With her appointment, the OP returned to the Ministry of Labor. Lewicka fully and enthusiastically accepted the *Security through Diversity* program, and intensified the work started by her predecessors (Chlon et al. 1999, 14). The prime minister also appointed a new president of ZUS, Stanislaw Alot (AWS). This meant that all the important for social security system posts were taken by AWS, disturbing the Freedom Union, which wanted its candidate appointed president of ZUS.

The new government, dominated by Solidarity appointees, made few significant changes in the design of reform. ZUS president Alot re-negotiated the information technology contract and launched personnel changes in ZUS – a behemoth with 40,000 employees – ostensibly to prepare it for becoming a clearinghouse for pension payments, but also to replace many mid-level managers with political appointees. AWS also adopted a new policy on the retirement age. In line with the party's conservative social values, AWS recommended keeping the retirement age at the level of 60 for women and 65 for men, rather than 62 for both men and women proposed in *Security through Diversity*. While an NDC first pillar had always been part of the *Security through Diversity* program, the government made the strategic decision that the first pillar law should not just be amended, but completely rewritten, to cover all the regulations concerning the old-age and disability pensions for the entire population covered. This slowed down the deliberative process in parliament and changed one of the basic political strategies of the pension reform up to that point: to leave the present first pillar rules intact in order to avoid lengthy debates. Rewriting the first pillar law allowed the government to combine a slew of previously-enacted legislation and rules into one single text, and also allowed the incorporation of two new groups into the first pillar: employees of the uniformed forces born after December 31, 1968, and judges and prosecutors. Judges and prosecutors, a key state interest group, later managed to avoid inclusion in the new system.

Public deliberation with civil society interest groups produced additional changes. The second set of draft laws was presented to the Tripartite Commission at the beginning of March 1998. Some of the main issues discussed concerned the legal status of ZUS, which the trade unions wanted to be kept strictly separate from the state budget. However, many other aspects were discussed, and government legislative drafts were deeply refined and revised during tripartite negotiations, thanks in part to trade union representatives, who commented on elements of the first pillar law connected with occupational schemes and early retirement privileges (especially for miners, with co-operation from the Solidarity miners' union leader Henryk Nakonieczny). Some differences proved impossible to reconcile. Within the tripartite working group on pension reform, union representatives also expressed concerns about the pension rights of people with occupational privileges, which were to be abolished for younger workers. The unions also differed from the office of the plenipotentiary on benefit indexation and on equal retirement ages for men and women. The OP was unsuccessful in trying to convince the unions of an equal retirement age. The OPZZ trade union complained it could not keep up with rapid changes in the draft laws, and did not have time consult the proposal with all its constituents.³ Therefore, the Tripartite Commission did not work out a final common position on the first pillar and pension system laws. Both major trade unions sent qualified negative opinions to parliament, especially on the first pillar law, expressing their concern about the issue of the occupational privileges. However, the unions did not mobilize to oppose the pension reform. Instead, a pact was reached between the government and the trade unions to allow the legislative process to go ahead, with the thorny issue of how to adapt special privileges to be negotiated with union representatives starting in the middle of 1998. However, this coincided with local government elections and the government did not want to have any serious political discussions before them. Negotiations were thus postponed until 1999.

³ According to their statute, members of Tripartite Commission have four weeks to prepare opinions on the draft laws presented to them by Government.

Poland launched a major public relations campaign in April 1997. In its first stage, until September 1998, the campaign focused on creating a general image of the reform and informing the main groups involved – unions, employers, public opinion leaders (politicians and media) – about the main principles of the new pension system. PR activities in the first stage included conducting opinion polls about the old pension system, creating a reform logo and graphic informational materials, training OP and ZUS employees in communication techniques, and preparing an OP web page, <http://reformaemerytalna.mpips.gov.pl/>

During public deliberation, the government continued its internal consultations on the new pension legislation. Most of the comments came from the Ministry of Finance and related to financial aspects of the proposed system. Other discussions on system coverage concerned the Ministry of National Defense and Ministry of Labor. A series of informal meetings took place with the representatives of the Church, concerning covering the clergy by the mandatory social security system and methods of financing (using the sources of a special Church Fund, which was at the disposal of the Ministry of Finance). Before the draft laws were sent to parliament, judges were excluded from the mandatory system, as a result of their constitutional right to the proper remuneration after the end of an active career, which was pointed out by the legislative department of the Prime Minister's office. This illustrates the power of well-placed state interest groups in pension reform.

The government approved the two second-phase laws on April 28, 1998, and sent them to parliament, asking it to form an Extraordinary Commission to discuss the government proposals, as with the first set of laws. This time, however, the government did not ask for a quick process of discussions. The issues covered by the laws were, in the opinion of most decision-makers, too complex to allow for such a procedure.

The extraordinary commission of parliament for pension reform began its meetings in May 1998. However, a dispute broke out among the partisan veto actors over who to appoint as President of the Commission. Freedom Union argued that it should chair the committee, since AWS held all the main social sector posts in the government. However, one AWS deputy thought that she should have recognition for her involvement in the reform process (she was a member of Solidarity team that prepared the union's proposal for reform and participated at the meetings of tripartite commission). Discussions on this issue lasted for a couple of weeks. Finally, a Freedom Union MP – Jan Litynski – was appointed president of the commission with votes from the Freedom Union and the opposition Alliance of the Democratic Left. This indicated that pension reform would not rely solely on votes from coalition deputies, but would include some representatives of opposition parties as well. In addition to the two coalition parties having slightly different views on several issues, some AWS deputies did not support the reform in full. Meanwhile, the Democratic Left was split between a managerial faction that supported radical change, and trade unionists who opposed key aspects of the reform.

As a result of these differences among the key partisan veto actors, when the commission started work on the first pillar law, it had to focus on each paragraph, discussing it in detail. This was mainly a result of Democratic Left Alliance (SLD) strategy. Because its government had initiated reform, the party could not turn against the law directly. But in opposition, the left-wing party tried to delay the process and avoid approving difficult changes in first pillar rules, which were against the interests of affiliated trade unions. The party opposed lowering replacement rates, eliminating income

redistribution, and eliminating occupational privileges in the mandatory system. As a result, discussions in the extraordinary commission took much longer than expected. However, the SLD was not exactly a veto player, since the coalition government should have had enough votes to pass legislation on its own. However, many of the SLD's objections drew considerable sympathy from deputies of the governing Solidarity Electoral Action, which also had a sizeable trade union component, and on matters of detail, the pro-reform coalition cut across partisan lines.

While the key partisan veto actors were finalizing reform legislation in parliament, new actors were being created as a result of implementation of the second-pillar law. In mid-1998, the regulatory agency for the second pillar, UNFE, was established. Cezary Mech, a member of the Christian National Union, a constituent party of Solidarity Electoral Action, was appointed president. Co-operation between UNFE and the office of the plenipotentiary was very difficult, since Mech proved to be a great fan of the Chilean-type reform and did not want to accept the different approach expressed in the Polish second pillar law. Some degree of co-operation was finally established by the end of 1998. UNFE was the first of the new policy actors to be created in the early implementation stage of reform. As a result of the stalemate in parliament, the government decided to delay launch of the second pillar until April 1999. However, the licensing process for pension societies and pension funds started as planned in August 1998. This enhanced the irreversibility of the reform process, since most of the Polish and international companies operating in the Polish market (banks, investment funds and insurance companies) became stakeholders in the new pension funds. Withdrawing the reform plan would have endangered the Polish government's reputation as a reliable business partner. Thus some of the new actors created as a result of implementation facilitated completion of the reform process, while others, like UNFE, added new complications.

Because of upcoming local elections and the shrinking time until implementation, the parliamentary commission decided to stop discussing the first pillar law and switch to the Social Security System law in August, the so-called "mother" law. The final version of this law was accepted in October. Major changes introduced in parliament included covering only new entrants to the uniformed forces and excluding prosecutors from the mandatory system. These two important revisions show that special state interest groups had a substantial impact on the debate in parliament.

Parliament returned to the first pillar law in October. The main issue remained how to deal with special occupational pensions granted under the old regime. Trade unions began to exert pressure at the beginning of December, when the Solidarity miners' trade union, under the leadership of Henryk Nakonieczny and Mr. Grajcarek protested against the proposals being discussed. After several meetings with the Minister of Labor and the plenipotentiary, miners' concerns grew, and they decided to take protest measures. Representatives of the miners' union occupied the Ministry of Labor for two days, demanding that the government extend early retirement options for miners by adopting so-called "bridging" pensions before the first pillar law was implemented. Under the proposed law, all miners who had worked less than 17 years under ground would have to continue working until age 65, instead of retiring after 25 years of working underground, regardless of age, as under the old system. Miners' concern about the pension system was enhanced by the process of coal industry restructuring that was closing down some mines. Negotiations also included the mining employers' organization. Employers promised to finance a part of a future bridging arrangement. The unions were partially satisfied with the solution, however they demanded a legislative solution before the first pillar law was adopted. Finally,

the Polish Senate adopted a slight change in article 41 of the first pillar law, which promised to include bridging pensions in another legal act. After the adoption of this amendment, the miners left the Ministry building. After these events, other miners' unions (OPZZ and branch unions not covered by the two national union centers) called for a strike, but did not stop the legislative process. The greater impact of the Solidarity-affiliated unions shows that the impact of civil society interest groups depends on their access to key veto actors in government and parliament.

Deliberation in parliament produced additional changes. An amendment to the first pillar law allowed a lower retirement age for those who fulfilled the work experience criteria for retirement, but had not reached the normal retirement age. This provision reflected increased dissatisfaction from both the OPZZ and Solidarity trade unions. A final dispute concerned indexation rates. Parliament decided that "notional capital" in the individual first-pillar accounts would be indexed quarterly to 75% of total wage fund growth. This was intended by deputies to prevent indexation rates from being decided ad hoc in the annual budget law. The government side had proposed a less generous half-price-half-wage indexation, but parliament did not accept this proposal. Advocates of lower indexation argued that this would allow contribution rates to fall more quickly, reducing unemployment, while opponents argued that it would have too great an impact on replacement rates, hurting pensioners. Opposition deputies disliked the notional defined contribution first pillar altogether, pointing out that it would reduce income redistribution. Therefore, coalition deputies provided the votes to adopt the first pillar law on December 17. President Aleksander Kwasniewski, a former leader of the opposition Democratic Left Alliance, signed the law on December 29 and on January 1, 1999 Poland's new pension system entered the implementation phase.

5.3.5 IMPLEMENTATION

Key features of the Polish reform are the change to a "notional defined contribution" first pillar, the establishment of mandatory, private second pillar funds for pension savings, and the creation of a legal framework for new types of third pillar voluntary funds (see Chlon et al. 1999 for a complete description). For employees participating in the new system, a payroll tax of 12.22% of gross wages will be contributed to an individual notional capital account and 7.3% to a private pension fund of the employees' choice. An additional payroll tax of 17.48% will continue to fund the disability pension system and a few other benefits paid by ZUS. Employees aged 30 and under must participate in both the new first and second pillars. Workers between the ages of 30 and 50 can choose whether to participate in the second pillar, or only in the reformed first pillar. People over 50 remain outside the new system. Several possibilities were created for the third pillar, including individual pension insurance and employer group funds, that may be set up and managed by consortia of employers and workers' representatives, including trade unions. The Solidarity trade union was involved in setting up the first such consortium, in cooperation with several leading financial institutions.

Some major design decisions continued to be made in the early implementation phase. In early 1999, the government renewed negotiations with trade unions over a "bridging law" that would resolve the thorny issue of occupational privileges. A special medical committee prepared new criteria for early retirement, forming the basis for bridging arrangements to be negotiated between the government, unions and employers. These criteria allow early retirement for those who work in special conditions (such as

work under ground or under water) that might influence the health status of the employee; and those who perform work of a special character (such as pilots and train engine drivers), that requires very good psychological and physical conditions for the public safety.

Implementation also showed up a lack of preparedness of ZUS and its information technology system, resulting in widespread public outcry, although this did not stop millions of Poles from joining the new, private pillar. Initially, all ZUS branches and offices were flooded by customers, eager to get forms, software and information about the reform. In order to facilitate public information, ZUS prepared new rules on sending information to ZUS and special software for employers to allow them to send necessary information via computer data transfers. The pension fund regulatory agency UNFE also began its work in February 1999, monitoring the activities of the pension funds, their advertising campaigns, and registering fund agents.

In October 1998, the implementation stage of the public relations campaign started. The main goal of this campaign was to inform people about new pension system rules and the choices for different age groups. It created a call-center, starting in March 1999, through which anyone would be able to order a brochure about the new pension system and have basic questions answered. In February, a media campaign was launched to inform people about the call-center, how the reform affects different age groups, and promoting the new ZUS. In addition to television ads, the Polish telephone company sent a reform booklet out with its April telephone bills. Government officials, parliamentary deputies and journalists had previously been invited on study tours to Chile, Argentina, Hungary and Sweden to learn about pension reform ideas that influenced the Polish model, with financing from a World Bank grant. The study tours developed understanding of reforms in other countries, resulting in support for the Polish reform. On February 16, pension funds were allowed to start their own advertising campaigns and the scramble for members began. Their activities are closely watched by UNFE, which intervenes in cases of unfair advertisements.

In April 1999, the office of the plenipotentiary was officially dissolved. Some of its employees shifted to the Department of Social Security at the Ministry of Labor, and some left the Ministry, working as consultants to the reform. Its main activities were to coordinate the PR campaign and stimulate cooperation between institutions, especially ZUS and UNFE. In addition, some legislative steps were taken in order to sort out mistakes that were made in the legislative process and to consider new laws including the bridging law, an annuity companies law, and a national actuary law, since the defined contribution system requires thorough actuarial supervision. Work on reforming the disability and the farmers pension system, two controversial elements of the pension system that were left aside for political reasons (Hausner 1998, 34) was planned to begin in the second half of 1999.

5.3.6 CONCLUSIONS

This section will conclude by reviewing the Polish case in light of the six hypotheses formulated above. The first suggested that policy legacies influence present reform choices. In Poland, as in Hungary, the size of the implicit pension debt appears to have played a role in convincing reformers that only a partial privatization of the pension system was feasible. However, full privatization was probably not feasible from a political standpoint either. Reformers' decisions were guided by fiscal

considerations, but also by political factors, such as the existence of veto actors within the government who wanted to maintain a large PAYG state pension system. Policy legacies thus played a role in restricting the size of Poland's private pillar, through a variety of different mechanisms, both economic and political.

A second hypothesis was that the fewer the number of veto and proposal actors and the smaller the distance between them, the greater the change in scope and size of the PAYG pension system. Poland provides an interesting contrast to Hungary. While the number of veto and proposal actors at most phases in Poland was equal to, or exceeded the number in Hungary, after the elimination of the Ministry of Labor as an independent proposal actor in early 1996, the proposals of the various actors in Poland were closer together. No proposal actor disagreed with the implementation of a funded pillar after that time. This enabled a somewhat more radical reform to go forward in Poland, despite a high number of veto actors, a change of government, and a two-phase legislative process involving both government and opposition. The Poland-Hungary comparison also shows the importance of proposal actors. While Hungary's Pension Insurance Fund was not a veto actor, its proposal was taken seriously by some trade union leaders, and through them, exercised a major influence on the size of the second pillar, scaling it back considerably through negotiations. In the absence of a proposal actor who opposed the implementation of a private pillar in Poland, trade unions never demanded a reduction in the size of the funded pillar. Instead, trade unions focused their attention on maintaining early retirement benefits and separate treatment for certain categories of workers.

The impact of interest groups in Poland did depend on their relations to key veto players, as predicted in hypothesis three. Judges and prosecutors, legal interest groups closely connected to the government, won special dispensation from the new system. The military was less successful, although only its younger employees will participate in the new system. While the independent railway workers' union failed to maintain the independence of its special pension system, both the railway workers and the Solidarity-affiliated miners' union won some special concessions on early retirement provisions. Especially notable in Poland is that both major trade union federations were affiliated with major veto actors, but both supported fundamental reform. Trade union federations' support for reform was critical to its passage in Poland. Trade unions now participate as co-founders of second-pillar funds (Solidarity), and as co-founders of third-pillar voluntary, employer-based schemes. These opportunities for participation were critical to winning their support for reform, as in Argentina (Brooks and James 1999).

As to the fourth hypothesis, World Bank intervention in the Polish reform process was extensive. World Bank funding was critical to the establishment and operations of the Office of the Plenipotentiary for Social Security Reform. World Bank reform ideas were transmitted directly through the appointment of a Bank official as head of the plenipotentiary's office. Again, while Poland had extensive direct World Bank intervention, it had less fundamental change than Kazakhstan, where World Bank direct intervention was more limited. What accounts for this? First, it indicates that the presence of a relatively high number of veto and proposal actors and a large implicit pension debt constrained what the World Bank could do. Second, it demonstrates that the transmission of reform ideas is often more powerful than direct interventions. In Poland, for instance, the idea to develop a notional defined contribution first pillar arose from the personal experience of the Polish World Bank official who headed Poland's office of the plenipotentiary. This official had previously worked in Latvia,

implementing a notional defined contribution first pillar there and thus had ideas that differed from the model in Averting the Old Age Crisis. Thus, the exact reform ideas of individual reformers, and their personal experiences, are as important in shaping the details of reform as direct World Bank interventions in policy planning.

The fifth and sixth hypotheses concerned tradeoffs across deliberative fora and phases of reform. Polish reformers clearly traded off a rapid reform process in favor of widespread agreement among the main partisan veto actors. A large part of this was the decision to make parliament the main deliberative forum for a complete revision of the first pillar law. The reasons they did so are complex. First, earlier experience with attempted pension reform had shown that there were a multiplicity of effective veto actors, and reform was not possible without broad societal agreement. Second, because the pension issue tended to cut across party lines in both coalition governments, it may not have been possible to pass legislation in either parliament without opposition support. Third, both the government and the Solidarity trade union wanted fundamental reform, and were ready to compromise on particulars to achieve it. Whatever the reasons, acceptance of fundamental pension reform by most parties means that Poland is unlikely to suffer the type of design reversals that occurred in Hungary in the early implementation stage, when a new government came to power and scaled back the private pillar. Poland may have traded extensive deliberation in the earlier stages, and reliance upon parliament as the main deliberative forum, for greater stability in reform implementation.

6 ACTORS AND THE POLITICAL-INSTITUTIONAL CONTEXT

While these three case studies have focused on structural features of the policy process, this section focuses on policy actors, comparing their involvement in the three cases. Who are the main actors in pension reform? What are their preferences? Do their preferences change over time? And under what conditions do they support fundamental pension reform? This section first considers the role of institutional and partisan veto actors, and then civil society and state interest groups typically involved in reform. It analyzes the importance of each actor, and shows that their preferences and positions on pension reform are neither fixed, nor wholly predictable based on their structural position in the broader political economy. Rather, the positions of most actors have proven to be relatively flexible, depending on perceived interests that may differ widely from those of similar interest groups in advanced industrial countries.

The political economy of social sector reform has often focused on the problem of overcoming resistance from entrenched interest groups. Social programs are often seen to create their own politics by endowing groups with a shared interest in guarding certain benefits. Pierson (1994) argues that “policy creates politics” insofar as the structure of particular policies determine the strength and cohesiveness of beneficiary interest groups. Their institutional strength then partially determines the extent to which reformers can change or withdraw benefits. Nelson (1998) extends this type of analysis by suggesting that certain government agencies have clear interests in the perpetuation of particular social policies. In the postcommunist context, Nelson posits an institutional interest on the part of welfare and social policy ministries to perpetuate the current PAYG pension system, which they have had a hand in setting up and administering, while ministries of finance typically support fundamental pension reform. Nelson illustrates this thesis with examples from Poland and Hungary.

Nelson (1998) further seeks to explain why pension reform was possible in these two cases, while health care reform was not.⁴ Her answer was that pension reform may not be as politically difficult as health reform, thanks to the relative lack of specific, concentrated interest groups that have a stake in the old system. In the health care sector, concentrated interest groups such as doctors, nurses, and health ministries are all likely to lose in a comprehensive reform, and therefore to engage in anti-reform mobilization. Fundamental pension reform does not affect concentrated interest groups in the same way. In the first place, the World Bank advocates pension reform that is designed to minimize impacts on current pensioners, by excluding them from the change of system. Excluding current pensioners neutralizes their concerns and prevents anti-reform mobilization from the most concentrated group of beneficiaries. Furthermore, allowing middle-aged workers a choice to join the new system, or to opt out, averts potential resistance from current workers and trade unionists. Meanwhile, younger workers and new entrants to the labor force are likely to gain from privatizing pension reform, since they will have a longer period of compounded investment gains. Young people therefore provide a potential constituency for fundamental reform in all countries. Thus fundamental pension reform is designed to minimize anti-reform mobilization from concentrated interest groups, much as Pierson (1994) would recommend.

Still, fundamental pension reform often involves a reduction in overall replacement rates, and harms the interests of groups enjoying special privileges under the old system. Therefore, reformers may expect resistance from certain state and civil society interest groups, including trade unions, pensioners' associations, and state pension administrations, that have an interest in the old PAYG system. Likewise, reformers may come under pressure from new actors created by pension reform, particularly prospective managers of private pension funds.

How do institutional and partisan veto actors perceive their own interests in reform? How do they deal with participation of civil society actors? This section begins with a review of the role of institutional and partisan veto and proposal actors in reform, and then turns to a consideration of state and civil society interest groups to assess their impact on reform.

6.1 INSTITUTIONAL VETO AND PROPOSAL ACTORS

Do institutional veto and proposal actors have predictable positions on reform? Drawing on evidence from Hungary and Poland, Nelson (1998) argues that Ministries of Finance typically support fundamental pension reform, while Ministries of Labor and state pension administrations support rationalization of the old PAYG system. On the other hand, in Kazakhstan, pension reform was pushed by a National Securities Committee, with equal support from both the Ministries of Finance and Labor. In Slovenia, reform was pushed by the Minister of Labor, with a lesser degree of cooperation from the Ministry of Finance. In Sweden, reform was developed by the state pension administration.

Therefore, while finance ministries are more likely to support fundamental reform than welfare ministries, all things being equal, these case studies show that the positions of institutional actors also

⁴ Although Poland later reformed its health care system in 1999.

often depends on personnel decisions that reflect the outcome of partisan political and ideological struggles within governments. If a prime minister or president is committed to reform, he or she may appoint a minister of welfare who is also sympathetic to fundamental reform. This happened in Kazakhstan, with the appointment of Minister of Labor and Social Protection Natalya Korzhova, in Hungary, with the appointment of Minister of Welfare Mihaly Kokeny, and Poland, with the appointment of Minister of Labor Andrzej Baczkowski.

Support of the government, the key veto actor in all three reforms considered here, depends a great deal on support of the prime minister, who has the power to appoint the ministers who hold veto power over reform within the government itself. In all three cases, pension reform took place after cabinet reshuffles in which anti-reform ministers were replaced by pro-reform ones on the decision of a prime minister who was recently appointed or became committed to reform. In Kazakhstan, pro-reform ministers were appointed on the authority of Prime Minister Kazhegeldin and President Nazarbaev, to indicate commitment to fundamental reform. In Hungary, the victory of liberals within the socialist-liberal government coincided with the resignation of an anti-reform Minister of Welfare, Pal Kovacs, and Prime Minister Gyula Horn's decision to appoint reformer Lajos Bokros Minister of Finance. In Poland, the appointment of Prime Minister Wlodzimierz Cimoszewicz paved the way for the removal of reform's major opponent within the government, Labor Minister Leszek Miller, and the appointment of reformer Andrzej Baczkowski in his place. In each case, support from the key institutional veto actors was central to government commitment to reform, while the institutional positions of key ministries changed over time.

6.2 PARTISAN VETO AND PROPOSAL ACTORS

Partisan veto actors provide a bridge between government and society. Parties typically represent one side of a historically defined social cleavage: communist versus anti-communist, urban versus rural, or rich versus poor. Do partisan actors have pre-determined positions on fundamental pension reform? This research suggests they do not. One surprising aspect of this type of pension reform is the extent to which it cuts across these historical social divisions in postcommunist Europe. Left parties have supported fundamental pension reform as an answer to the widespread crisis of the postcommunist welfare state. Right and liberal parties are sometimes ideologically committed to the privatization that lies at the root of fundamental reform. But both left and right parties also tend to contain interest groups that oppose fundamental reform. For this reason, partisan veto actors often play a role in moderating reform proposals. In Hungary and Poland, the left parties that implemented reform included both liberal leadership groups that embraced change and traditional left constituencies that opposed it, and fought to reduce the size of the funded, private pillar. Similar divisions exist between the economically-liberal and populist wings of the right parties in both countries. Only smaller liberal parties are relatively consistent supporters of fundamental pension reform. However, the cross-cutting appeal of fundamental pension reform generally means that most parties will contain some sympathizers, and also some opponents. This may broaden the appeal of reform, but also limit its consequences.

6.3 INTEREST GROUPS

Interest groups may have an impact on reform by mobilizing against reform and seeking to play a veto role, by formulating their own encompassing reform proposals, or by advocating a more narrow agenda that guards group interests within the reform. Most interest groups follow the latter route, although there are some cases of interest groups threatening to play a veto role, as in Hungary, or formulating their own proposals, as in Poland. Generally, we can distinguish among two types of interest groups: state interest groups that reflect the interests of some part of the state administration, and civil society interest groups that represent the interests of some relatively independent segment of society. Interest groups are expected to have an impact on reform that is closely related to their relations with key institutional and partisan veto and proposal actors. This section will discuss four of the most important interest groups involved in reform in the three cases – trade unions, pensioners' associations, state pension administrations, and private pension funds – their influence in the reform process, and how they have been convinced to support fundamental reform.

6.3.1 TRADE UNIONS

Trade unions in the postcommunist states can be divided into two types: those that played a prominent role in the socialist system as "transition belts" of party commands to the working class -- what I will call "old" trade unions -- and "new" trade unions with roots in the anticommunist opposition. "Old" trade unions are sometimes allied with communist successor parties or other left parties, while "new" trade unions gravitate toward right-wing, Christian-Democratic, or nationalist parties. Politicized historical divisions often place "old" and "new" trade unions at odds on contemporary policy matters. Their positions on fundamental pension reform therefore must be discussed separately.

6.3.1.1 OLD TRADE UNIONS

Old trade unions have deep roots in the prior regime. They typically have reformed since the transition, in most cases changing their name and organizational structure, and even personnel. The degree of transformation differs quite radically from country to country. However old unions tend to suffer from a negative public image, regardless of their level of institutional self-renovation. Old trade unions often remain committed to the social security institutions of the prior regime, in part because they played a large part in that system, most notably distributing social benefits at the enterprise level, but also at the national level, for instance managing networks of recreational facilities (Cook 1997, 12; Myant and Waller 1994, 177). Old trade unions often maintained ownership or control over vast economic resources during the transition, and hence have emerged as relatively powerful economic actors in some countries, although the management and mismanagement of these resources differs significantly across countries. Ownership of real estate is sometimes a key asset for old trade unions (Cook 1997, 12). However, extensive resources inherited from the past have proved to be a mixed blessing. While they might allow old unions to do more, in most cases they have prevented them from behaving like a "real" trade unions in the Western sense. Union leaders are often more concerned with managing their economic empires than with day-to-day organizational issues. Efforts to organize workers, new private workplaces, or undertake other representative activities are often minimal (Cook 1997, 18). Their economic resources and organizational inheritance from the past (including an extensive network of enterprise offices, often maintained at enterprises' expense), has made them less

willing and able to engage in effective new pursuits (Myant and Waller 1994, 177). Relative wealth has also made them targets of resentment from new trade unions, compounding historical disputes. In many postcommunist countries, including the three countries discussed here, there is a raging battle between old and new unions over disposition of old trade union assets (Bartlett 1997, 152). New unions want a share of old union assets in the spirit of democratization and free competition; this leads to intense infighting among the unions, and hampers potential cooperation.

Because of the left-leaning political and social views of their leaders, their institutional interests, and their connections with the past regime, old trade unions in the postcommunist countries tend to oppose radical pension reform. Such opposition may be ideological, rooted in a stubborn refusal to countenance any withdrawal of the guarantees of state socialism. In other cases, old trade union opposition may be rooted in their institutional interests, for instance in protecting extensive special privileges of powerful sectoral trade unions, or maintaining trade union provision of social services. Nonetheless, in two of the three cases studied here, Poland and Hungary, old trade unions have been convinced to accept the partial transition to a funded system, despite inherent or inherited predispositions.

In Kazakhstan, pension reform went ahead despite old trade union opposition. In this case, trade unions' ability to pursue their interests was limited by their lack of access to the policy process in a strong presidential regime. Old trade unions consistently voiced opposition to radical pension reform proposals and emphasized the lack of guarantees in the new system, the lack of an adequate minimum pension guarantee, and the lack of public confidence in government promises, though they did not mobilize workers against reform prior to implementation. Had the parliament had effective veto power, Kazakh trade unions probably would have had more influence on the final shape of reform, since their claims met with sympathy in parliament. Indeed, after reform was enacted, old trade unions teamed up with a group of parliamentarians to reintroduce special privileges into the pension law (see section 5.1.4 above).

In Hungary too, the old trade union federation (MSZOSZ), initially opposed pension reform. Its representatives on the Pension Insurance Fund (PIF) supervisory board fought the introduction of a mandatory funded system and instead proposed changes to the existing PAYG system. However, union leaders were eventually convinced to support reform through a series of political deals. Some involved actual changes to the pension reform project, while others provided institutional advantages to the old trade union organizations. Old trade unions in Hungary pushed for additional guarantees to the second, private pillar, for a smaller second pillar, for a larger guaranteed minimum pension, higher indexation, and for lower eligibility requirements for vesting in the second pillar (see section 5.2.3 above). Compromises were made in the forum of the Interest Reconciliation Council that satisfied trade union concerns on most grounds, without undermining the radical nature of the reform. The size of the second pillar contribution was reduced from 10% to 8%, and phased in over two years, starting at 6% in 1998. Trade unions agreed to Swiss indexation, but won large real increases in pension levels *a priori*. A number of other compromises were reached.

The old trade unions also accepted political-institutional side-payments to secure their acceptance of radical pension reform, winning "delegation" of seats on the Pension and Health Insurance Fund supervisory boards, instead of facing popular election. This particularly benefited the old trade

unions, which had won elections in 1993, institutionalizing their control over substantial financial resources. However, this political bargain proved short-lived. The entire substantive and institutional bargain with the old trade unions was overturned when the Socialist Party lost elections in May 1998 to the right-wing party, FIDESZ. FIDESZ cancelled promised increases in pension levels, froze contributions to the private funded pillar at 6%, and eliminated the independent Pension and Health Insurance Funds altogether. In any case, the gains secured by the trade unions in Hungary were short term. Palacios and Rocha (1998) have shown that the compromises made to the old trade unions and other groups in Hungary's Interest Reconciliation Council (IRC) would have cost between 0.5 and 1.0 percent of GDP during the first years of transition to the new system, but would have had little after 15 years. This suggests that old trade unions may be bought off by concessions that have a short- to medium-term impact, but do not fundamentally threaten reform over the long term.

In Poland, the main old trade union federation (OPZZ) came to support reform after negotiations in that country's tripartite council -- a body like the IRC in Hungary that brings together government, business, and labor representatives for regular discussions over important legislative and socioeconomic matters. In an official resolution of the OPZZ trade union congress in May 1998, the OPZZ "decidedly" supported radical pension reform with a 9% contribution to the second, funded pillar (Resolutions 1998, 8). This agreement was the product of negotiations within the tripartite body, and also may have reflected competition with the Solidarity trade union, which supported fundamental pension reform. However, the OPZZ did emphasize certain conditions to its support, and pursued these vigorously in parliamentary debates on pension reform. The OPZZ demanded that the PAYG pillar remain the "main source of income for present and future pensioners," and expressed concern over how the government would fund the deficit in the public pillar. OPZZ also opposed changes to the retirement age, minimum pension levels, indexation changes, and special privileges that were essential parts of the pension reform in Poland. Since the switch to a notional defined contribution system for the first pillar in Poland was equally important to the introduction of a second pillar, OPZZ's conditional support for a partially-funded system coincided with effective opposition to other elements of the reform. Thus, old trade unions in Poland agreed in principle, but remained a difficult ally throughout the legislative process, contributing through their representatives in parliament to point-by-point battles over the reform effort in committee debate. Still, OPZZ's fundamental support for reform prevented it from organizing mass opposition to reform. OPZZ won a number of concessions for buying out special pension privileges granted under the old system, compromises that would have an important medium-term impact on middle-aged workers in formerly privileged sectors, but little long-term fiscal impact. OPZZ also planned a joint venture with Multica and TBI Holding (a Belgian subsidiary of Bankers Trust) to establish and market a second-pillar pension insurance fund. Although its application was rejected, this suggests that trade unions, new and old, have the potential to strengthen their financial clout through second-pillar reform, a substantial inducement to support radical change. Polish unions have been more forward-looking than Hungarian ones in this regard. It will be interesting to see whether they will be able to leverage their extensive working-class networks into long-term financial power. In Poland, old trade unions clearly saw potential financial benefits in participation in the new system, while in Hungary, heavy old trade union involvement in the former pension fund administration made it more resistant to change.

In both Poland and Hungary, old trade union support for reform was also facilitated by participation in left party coalition governments at the time of reform. Participation in left electoral

alliances encouraged old unions to accede to government pension reform plans, particularly since right-wing parties in postcommunist Europe often have adversarial relations with old trade unions, and cooperation across this historical-political divide would be even more difficult. Pension reform in the parliamentary democracies of Central Europe has so far been initiated by center-left governments. This can be explained, in part, by the potential opposition role of the old trade unions, and their greater potential for cooperation with social policy reforms initiated by a left government. A right government proposing similar measures would likely meet with organized resistance from the old trade unions that are often major political opponents of the right.

6.3.1.2 NEW TRADE UNIONS

New trade unions built by the anticommunist opposition have tended to support market-oriented reforms (Ost and Weinstein 1999, 9), including the introduction of individual private pensions. The Free Trade Union Congress of Kazakhstan supported radical reform, as did the Solidarity trade union in Poland. Right-wing trade unions in Hungary were split, with some supporting reform and others opposed, but none organized mass resistance to the reform, nor took any action which impeded the progress of reform or forced significant compromises. Experience shows that new trade unions can be natural allies of radical pension reform. New trade unions tend to be smaller and less powerful than old trade unions, although Solidarity in Poland is an exception to this rule. New trade union support also may act to neutralize old trade union opposition.

New trade unions exist in all postcommunist countries, but are usually less powerful than old trade unions. In Kazakhstan, for instance, the Free Trade Union Congress has always operated in the shadow of its conservative rivals, without the inheritance of important resources and networks from the past. Since civil society development has been suppressed under President Nazarbaev (Olcott 1997), there is little prospect for the Free Trade Unions to improve their organization or access to financial resources. In Hungary, a number of right-wing trade unions exist, with varying degrees of membership and political support. However, none have been particularly active in the policy process. Poland is the big exception in this regard, with its Solidarity trade union playing an enormous role in contemporary politics. Solidarity played a central role in toppling communism in Poland, and its successor organizations have dominated several postcommunist Polish governments. Solidarity Electoral Action, an alliance of right-wing parties led by the Solidarity trade union, is currently the senior government coalition partner, along with the Freedom Union, which also has its roots in the Solidarity movement. Solidarity also has its own independent expert capacity for policy formulation.

Solidarity, like most other new trade unions, has always favored the introduction of market reforms, with a social or Christian-democratic twist. In the case of pension reform, Solidarity prepared its own pension reform proposal, based on a rationalized PAYG pillar, and individual private pension funds established with privatization assets. In essence, Solidarity's program was not far from the Security through Diversity concept, except for the way it suggested employing privatization assets. Solidarity had long wanted to promote a type of privatization that would benefit the whole society, and it proposed a method of using shares of privatized companies to endow pension funds with individual accounts. While this method was not included in full, the Polish program does foresee the use of privatization revenues to fund the transition deficit, in a way that was hammered out with Solidarity officials. Solidarity was brought into discussions over pension reform by plenipotentiary Andrzej

Baczkowski, and many of its suggestions were included in the *Security through Diversity* program. When Ewa Lewicka of Solidarity Electoral Action was appointed Plenipotentiary for Social Security Reform during the second phase of coalition-building in Poland, she was able to continue work on the Security through Diversity without major revisions. Toward the end of the coalition-building phase, the Solidarity miners' union took protest action against the reform, arguing for a concessions on the reform of special privileges granted to miners. After a multi-day sit-in in the Ministry of Labor, the miners union agreed in discussions to call off their protest in exchange for a government assurance that their concerns would be addressed as soon as reform was enacted. It was significant that this concession came from a Solidarity government, which had the credibility to make it convincing.

New trade unions may also be more likely to take an active role in economic opportunities offered by fundamental reform. In Poland, Solidarity is a cofounder of one second pillar fund, in a joint venture with Zurich Insurance Group. However, Solidarity is also using provisions guaranteeing union participation in third pillar enterprise pension funds to its advantage, informing its local leaders how to set up third-pillar funds of this type. The inter-enterprise third pillar funds, as conceived in Poland, could provide a powerful coordinating role for Solidarity trade unions. Similar opportunities for substantial trade union participation in the third pillar may provide incentives for their support.

6.3.2 PENSIONERS' ASSOCIATIONS

Oddly, pensioners' associations have played almost no role in pension reform in Hungary or Poland (Nelson 1998), but they have been prominent in Kazakhstan. The explanation for this seems to be that pensioners in Kazakhstan were hyper-mobilized at the time that pension reform occurred thanks to the arrears crisis, when massive pensioners' protests emerged. In Poland and Hungary, present pensioners were not expected to be affected by radical reform. In order to head off resistance from present pensioners, reforms advocated by the World Bank usually only touch workers aged 50 and under, who either must participate, or are given the choice to participate, in the new system (Palacios and Whitehouse 1998). In Kazakhstan, participation in the new system was made compulsory for all workers, thus mobilizing opposition from workers nearing retirement. In other countries, older workers who are most likely to be thinking about retirement are not affected, and neither are current pensioners. Pensioners' organizations do exist in most postcommunist countries, but their effectiveness may be limited by their relative lack of importance in major parties' electoral coalitions. In Poland, as in several other postcommunist countries, pensioners' parties were founded and competed in elections in 1997. However, split between right and left, they did not win representation in parliament. One pensioners' association affiliated with the Democratic Left Alliance did have its concerns voiced in parliament, but its proposals were not adopted. Political parties remain an important channel for interest group concerns, and failure to exercise power within established parties has lessened the influence of pensioners' associations.

The Kazakh case is special, showing that pensioners' associations have the potential to actively oppose radical reform, but only when previously mobilized and actually threatened by reform. In Kazakhstan, pension reform took place in the wake of massive arrears crisis. Payroll taxes were not collected, or were stolen, and payments were not being made in a timely fashion, causing street protests and hunger strikes across the country. These protests were loosely organized by a number of different

old peoples' associations, including most prominently the Pokolenie (Generation) movement. Veterans' associations were also vocal opponents of radical reform. These groups initially mobilized to force the government to honor its pension guarantees under the old system, but when the switch to a funded system came on the agenda, these mobilized groups opposed the change. They argued vigorously against reductions in minimum pension guarantees under the new system, the phasing out of the PAYG system and the principle of intergenerational solidarity, and expressed distrust that reform would not affect current pensioners. In theory, the reduction of the payroll tax going to the old system from 25.5% to 15% should not affect the amount spent on present pensions, since the government plans to finance the spending in some other way. However, in Kazakhstan, where arrears have been a major problem and actual monetary intakes had constrained spending in a very ad hoc fashion, present pensioners were concerned that their pensions would continue to be reduced or not paid, should payroll taxes be reduced. Thus, the shaky fiscal environment and low confidence in government played a key role in mobilizing current pensioners against fundamental reform.

6.3.3 STATE PENSION ADMINISTRATIONS

State pension administrations in the postcommunist countries often contain experts on pension reform who are predisposed toward reforming the PAYG system, rather than introducing a mandatory funded pillar. However, the overall position of state pension administrations has depended mainly on political decisions, appointments and leadership, as with ministries. In Poland, for instance, the president of ZUS, the state pension administration, is a political appointee who serves at the behest of the prime minister and the government. This has meant that prime ministers who support reform may appoint ZUS chiefs who also support reform. In such a situation, a capable administrator can prevent other pension administration experts from voicing opposition to reform, although this is not always possible or desirable. On the other hand, state pension administrations are sometimes independent of government control, as in Hungary. There, the leadership of the state pension administration, PIF, was chosen in a general election by voters for a set term. During the period of reform in Hungary, the PIF was under the control of representatives mainly from the old trade unions. However, when the prime minister can appoint a new head of the pension administration, its opposition can be effectively neutralized if there is sufficient prime ministerial commitment and through deals that give the old pension administration a role in the new system.

6.3.4 PRIVATE PENSION FUNDS

Pre-existing third pillar pension funds have also had an important impact on reform, particularly in Hungary. Voluntary third pillar pension funds usually regard the establishment of a mandatory second pillar as a threat to their business. They may be concerned that second-pillar contributions will crowd out investments in their funds. On the other hand, existing private pension funds may be convinced to participate in the second pillar. In this case, they tend to lobby for making the organization and regulation of the second pillar match their current organizational structure. They lobby to establish regulations that provide their funds with different forms of comparative advantage, and limit the number of regulatory bodies they must deal with. In Hungary, pre-existing third-pillar pension funds had a substantial impact on reform. The regulatory body set up for the third pillar reform in 1993 launched a

successful effort to make second pillar funds mirror the organization of the third pillar, and place them under the regulatory authority of the same third-pillar body. In Poland, private pension funds protested against the establishment of a special regulatory body for second-pillar funds, preferring to extend the current regulatory regime, headed by the Securities and Exchange Commission. However, they were unsuccessful, due to the confrontational tactics they took. Polish pension fund companies further lobbied against the high level of reserves required in the law and against the minimum return guarantee that discourages risky investments. Fund management companies were also active in lobbying for specific marketing regulations that would enable their marketing strategies. Pension fund companies tend to be weak at the early stages of reform, but become stronger during implementation, since they become necessary to the functioning of the private pillar. This suggests that governments should use the commitment- and coalition-building phases, when financial interests are weaker, to introduce a sufficient regulatory structure that might not be possible later on.

7 CONCLUSIONS AND POLICY RECOMMENDATIONS

This report presented five hypotheses about the influence of political-institutional factors on pension reform in three postcommunist countries. In this conclusion, I will first summarize the outcomes of reform, then test the validity of the hypotheses against the evidence presented in the case studies, and finally educe recommendations for policymakers seeking to further fundamental pension reform in the postcommunist countries.

7.1 REFORM OUTCOMES

All three countries considered in this report substantially reduced the size of their public PAYG pension systems, and implemented new funded pillars. Table 5 summarizes the main changes enacted in each country. Kazakhstan clearly had the most fundamental change of the three cases, entirely phasing out its public PAYG system over time. By contrast, Poland and Hungary both maintained relatively large public PAYG components, although both countries made dramatic changes. Hungary introduced tighter eligibility requirements, Swiss indexation, and a substantial increase in the retirement age, while Poland made a transition to a notional defined contribution scheme, that will record individual contributions in special notional capital accounts. Kazakhstan will also direct a larger share of gross wages, 10 percent, to the new private pillar, compared to 7.3 percent in Poland and 6 percent in Hungary. Although the contribution rate to the second pillar is slightly smaller in Hungary, it is approximately the same as a percentage of total pension contributions, since Poland also has a larger contribution rate to the overall public system, at 29.7 percent versus 24 percent in Hungary. Poland also enacted a substantial reform of the third pillar, which had been completed earlier in Hungary. The following sections explore the reasons behind some of the observed differences in the three reforms, in light of the five hypotheses developed in sections 2 and 3 of this report.

TABLE 5. FUNDAMENTAL PENSION REFORMS IN KAZAKHSTAN, HUNGARY, AND POLAND

	Size of contributions to first and second pillars	Major changes in first pillar	Major features of second pillar	Major changes in third pillar
Kazakhstan	15% to public PAYG system gradually decreased to zero; 10% to second pillar.	Gradual elimination of PAYG system; Replacement with minimum pension guarantee; Continuation of phased increase in retirement age to 63/58 in 2002.	State Accumulation Fund is the dominant player in the second pillar, offers state guarantees and safer investments; Private pension funds have 15% of market.	
Hungary	24% to first pillar; 6% to second pillar.	Tighter eligibility; Swiss indexation; Retirement age to increase from 60/55 to 62 for both men and women by 2008.	Private pension funds organized as mutual benefit societies; Regulated by same agency as third pillar funds.	
Poland	12.22% to first pillar; 7.3% to second pillar; 17.48% to disability and other benefits.	NDC first pillar; Retirement ages unchanged at 65/60 for men/women; Benefit based on actuarial formula.	Private pension companies; Supervision by new Pension Fund Supervisory Board.	New regulatory structure for third pillar allows for savings through life insurance and inter-enterprise pension funds with employee representation.

Sources: Cangiano et al. (1998); Muller (1999).

7.2 POLICY LEGACIES

The first hypothesis, derived from Weir and Skocpol's model of the social policy process, states that policy legacies influence present reform choices. In the case of pension reform, countries with high implicit pension debt were expected to choose to retain a larger public pillar and a smaller private pillar. This study confirms the findings of James (1998b, 460), showing a correlation between high implicit pension debt and size of the new public pillar. Kazakhstan had the lowest implicit pension debt of the three countries examined here, and had the most radical reform, with the most drastic reduction in the size of the public pillar, and the largest proportion of contributions channeled to the new private pillar, 10 percent of gross wages. Hungary and Poland retained large public PAYG pillars, and implemented smaller private pillars.

While confirming these results, this paper has advanced understanding of the mechanism by which they occur. Perceptions of affordability are important, as reformers in Hungary and Poland did not push for a steeper reduction in the public PAYG system and a larger private pillar in part because they did not think it could be financed. But in part, larger PAYG systems were protected in Hungary and Poland by more powerful advocates within the reforming governments and partisan veto actors. This suggests that larger PAYG systems have deeper political support, making them more difficult to reduce, regardless of financing issues.

Policy legacies also influenced other features of reform. For instance, the design of pre-existing private pension funds had a major impact on the design of the second pillar, suggesting a strong path dependency. In Hungary, third pillar voluntary private funds were established in 1993, before the launch of fundamental reform. These funds lobbied successfully to render the organization of the new second pillar similar to their own, and to use the same regulatory body. Part of their effectiveness came from their closeness to the main partisan veto actor, the Hungarian Socialist Party, many of whose officials were involved in the third pillar.

While policy legacies were important in certain respects, in many other ways, these fundamental reforms wiped out key features of the previous pension system, in particular the special pension privileges that were prevalent under communism, and that should have been the most difficult to alter, according to prevalent theories (Pierson 1994). This monumental change took place in all three countries, and went directly against the interests of certain concentrated interest groups, including miners, railway workers, judges, military officers and pilots. This indicates that policy legacies and the resilience of welfare state institutions are systematically weaker in the postcommunist states than in advanced industrial countries.

7.3 VETO AND PROPOSAL ACTORS

Building on the work of Tsebelis (1995) and Immergut (1992), I hypothesized that the extent of change in the new pension systems would depend on the number of veto and proposal actors involved in reform, and the policy distance between them. This hypothesis has been substantiated by the case studies above.

Kazakhstan had the smallest number of veto actors, and the most radical reform, while Hungary and Poland had comparably large numbers of veto actors, and reforms that included a moderate reduction in the public PAYG system, and the introduction of private, funded pillars of approximately one-quarter to one-third of total contributions. Furthermore, based on the record of parliamentary debates, there is every reason to think that if the Kazakh parliament had been a true veto actor, then Kazakhstan would have had a more moderate reform. The number of veto actors appears to have a major impact on the degree of reform.

What about proposal actors? I have introduced the concept of proposal actors in this report, because it would have been impossible to analyze the process of pension reform by looking at veto actors alone. Veto actors in these three cases often did not have fixed policy positions and relied on others to propose reform ideas. Similarly, some proposal actors, whose ideas were the source of much debate and innovation, were not veto actors. The evidence shows that combined veto and proposal actors had the greatest influence on reform, for instance in the case of the special offices for pension reform that were important in every case. Support of veto actors, such as the President of Poland, was obviously important, but did not do much to shape the specifics of reform. What was the impact of proposal actors that were not veto actors, such as the Solidarity trade union in Poland or the Pension Insurance Fund (PIF) supervisory board in Hungary? The evidence shows that these non-veto proposal actors also had an important influence on reform. Proposal actors set the terms of debate in a country, and provide ammunition and expertise for sympathetic groups. In the case of Hungary, the PIF

proposal was important because it lent credibility to trade union reservations, strengthening their bargaining position. Similarly in Poland, the fact that the Solidarity proposal also called for a partially-privatized pillar was vital, because it allowed a general agreement to emerge between government and opposition that facilitated passage of the new system in parliament. Proposal actors with comprehensive and expert reform ideas can have a major impact on reform, whether or not they are veto actors.

7.4 INTEREST GROUPS

Civil society groups without a well-elaborated reform proposal, that instead pursue a partial, and often self-interested, agenda with regards to reform can also have an impact. This impact was hypothesized to depend on their relations to and distance from important veto actors, and their ability to mobilize constituencies to exert pressure at critical veto points. Evidence from the case studies also supports this hypothesis. For instance, in Kazakhstan, pensioners' associations mobilized extensively to oppose reform, but had little effect because of their marginalization from power. The lack of a parliamentary veto considerably weakened their ability to influence the political process. In contrast in Poland, when Solidarity miners' unions mobilized to put pressure on the government to agree to special early retirement arrangements, they were successful mainly because of their strong ties to the then ruling party. In Hungary, where few civil society groups mobilized extensively against reform, interest groups that did have a substantial impact were ones closely allied with the main partisan veto actor, the Socialist Party. Similarly in Kazakhstan, the only interest group to gain special treatment in the new system, employees of the military and internal affairs agencies were powerful within the government.

7.5 WORLD BANK INTERVENTIONS

World Bank interventions and ideas have proven to be influential in reforming countries, as hypothesized. Direct interventions in Poland and Hungary were critical to the design and completion of reform. And while the World Bank did not intervene in Kazakhstan until after the design phase, it did provide a \$300m loan that helped the reform to go forward. What is striking is the variation in the type of outcomes that are possible with World Bank assistance. All three cases show that the World Bank generally encourages reform programs that include a substantial private, funded pillar, in which the funds are privately managed, but the shape and size of this pillar may vary radically, depending on the advice given by individual World Bank staff members and consultants, and local conditions.

The case studies underscore the importance of ideas in shaping the reform process in each of the three countries. Kazakh reformers began to design a partially-funded system, in part, after reading Averting the Old Age Crisis and participating in World Bank conferences on pension reform. This suggests that World Bank influence can be exerted indirectly, through contributions to global social policy discourse. Evidence from Poland confirms this result. The introduction of a notional defined contribution first pillar in Poland reflected the influence of specific World Bank advisers and their particular ideas and experiences. In Hungary the technical and modeling expertise of World Bank staff and consultants was critical in analyzing the consequences of different policy options and therefore in providing reformers with ammunition that they could use to overcome opposition. World Bank influence through ideas and direct interventions is thus found to be powerful, but also more variable than

expected. Of course, it is also plausible that the ideas were listened to more carefully because the World Bank had money to back them up.

7.6 TRADEOFFS ACROSS DELIBERATIVE FORA

A fifth hypothesis concerned tradeoffs across deliberative fora. It suggested that negotiation in one forum can sometimes substitute for deliberation in another, and because different fora tend to privilege different actors, that reformers should think strategically about which deliberative fora to focus on. In some cases, the evidence seems to indicate the availability of such tradeoffs. For instance in Hungary, deliberation in the Interest Reconciliation Council appears to have lessened the pressure for extensive deliberation in parliament, where some of the same interests were represented, notably the leftist trade unions. In Poland, reformers employed the usual practice of extensive deliberation in parliament, lessening the impact of other deliberative bodies at the final stages of reform. In Kazakhstan, no deliberative body was particularly important, since its tripartite council had little impact on reform outcomes, and its parliament was not given a veto role. Opposition to reform was mainly voiced in the press and a series of public meetings organized by the government for informational purposes. Therefore, the case studies provide some evidence, but not overwhelming evidence, of the potential for tradeoffs across deliberative fora. Some fora, like parliament, are unavoidable and necessary to any legislative process. Similarly, tripartite negotiation in interest reconciliation councils is often mandated in postcommunist countries. However, reformers also have significant choices about which fora to focus on, and these have an impact on which actors have the most influence over the final shape of reform.

7.7 TRADEOFFS ACROSS REFORM PHASES

The sixth hypothesis posited tradeoffs across phases of reform. Involving only a small number of veto and proposal actors in the commitment-building stage may lead to a more radical basic design, but may also force greater compromises at the coalition-building stage, when new veto and proposal actors finally must be consulted. Excluding potential veto actors at the coalition-building stage may speed reform, but cause backtracking in implementation, when these actors take power or mobilize against reform. However, involving all key actors at an early stage may water down reform and prevent the implementation of a sizeable private pillar. No simple solutions exist, but the three case studies above do verify the existence of tradeoffs between the three stages of reform.

Kazakhstan produced the most radical and rapid reform by narrowing down the number of veto and proposal actors through a special legislative process that tied the hands of parliament, effectively eliminating its veto power, and by conducting the planning of reform in secret, thus reducing chances for alternative veto and proposal actors to voice their concerns. However these methods of exclusion helped to delegitimize the reform, contributing to spontaneous mass noncompliance in the first months of implementation, and to 85% of citizens initially choosing the State Accumulation Fund over private pension funds. An exclusive policy process also caused anti-reform mobilization during implementation that threatened to renew some special privileges. By contrast in Hungary, the policy process included only those interest groups close to the ruling coalition, while excluding others. This coalition-only

process facilitated quick passage of reform legislation, but also contributed to a serious reversal in the early implementation stage, when an opposition party came to power and scaled back the new private pillar. Poland meanwhile had the longest commitment-building and coalition-building processes, painstakingly fighting every battle and negotiating reform with all relevant parties. This slowed the reform process, but eventually enabled the implementation of a reform that has the confidence of all major veto and proposal actors, and therefore seems less likely to suffer from anti-reform mobilization or significant design reversals in implementation.

7.8 POLICY RECOMMENDATIONS

How can the World Bank better pursue its social policy agenda in a political environment characterized by multiple veto and proposal actors? Can it do more to offset legacies of communist-era social policies? Can it better manage tradeoffs across stages of reform? This section derives policy recommendations from findings related to each of the six hypotheses presented above.

7.8.1 POLICY LEGACIES

The World Bank already does a great deal to help countries deal with the legacy of past pension systems, mainly by loaning them money to finance the transition to a funded system. For instance, the World Bank granted Kazakhstan a \$300 million loan to finance its transition. It is not clear that the World Bank can do more to lessen the burden of policy legacies reflected in implicit pension debt. The availability of World Bank financing sends a strong signal to policymakers, encouraging them to consider fundamental change, including a mandatory, funded pillar. With financial assistance available, the main challenge for the World Bank is to adequately tailor its advice to local conditions and convince policy actors of the desirability of fundamental reform.

7.8.2 VETO AND PROPOSAL ACTORS

The World Bank is most likely to achieve its reform objectives when it dominates advice to the sole proposal actor in a pension reform process. However, in the initial stages of reform in most countries, the World Bank often finds itself in competition with multiple veto and proposal actors. In such a context, the World Bank needs to convince the top institutional veto actors, including the prime minister and president, to support proposals for fundamental reform, and to eliminate alternative proposals from consideration. In every case examined here, this was achieved through the establishment of a single governmental special office or working group for pension reform, dedicated to fundamental change. Establishment of such a special office often signals governmental commitment to fundamental reform and resolves internal conflict over basic reform design.

In the early stages of reform, the World Bank's main objective should be to establish such a special office with a clear government mandate for fundamental reform. If no alternative proposal actors exist, a special office should be set up at the very start of the policy process, with broad participation from key veto actors, as in Kazakhstan. However, if alternative proposal actors are already mobilized

and oppose fundamental reform, the World Bank may initially have to operate through other channels, without full governmental commitment to reform. The Hungarian case is instructive in this regard. Lacking support from the whole government, the World Bank in Hungary initially funded a Finance Ministry working group on pension reform, that battled Ministry of Welfare resistance to a private, funded pillar. Once the Hungarian prime minister committed to fundamental reform, an interministerial working group could be formed, with representatives from both ministries.

The World Bank should give careful consideration to the structure of special offices for pension reform. A special office is often conceived as a technical unit charged with designing the reform program. However, its role may go well beyond this. First, it may play an important role as a deliberative forum for reconciling differences among alternative proposal actors. Second, the special office can play an important coordinating role in the implementation phase, helping to integrate new actors into the pension reform process, and troubleshooting reform regulations and procedures.

As a deliberative mechanism, the special office can operate in different ways. A special office can be exclusive and secretive, as in Kazakhstan, producing more radical reform at the expense of low public awareness and support for change. On the other hand, a special office can also provide a mechanism for generating inclusive deliberation. For instance, special offices or working groups in Poland and Hungary exhibited important elements of inclusiveness. In Hungary, the inter-ministerial working group on pension reform included experts from the Ministry of Welfare, who had previously opposed reform, as well as a representative of the Hungarian financial community. Poland's special office included non-governmental experts, who had a major impact on the shape of reform, and helped to insure opposition political support for the proposal in parliament. While inclusiveness inevitably forces compromises, both cases show the potential political benefits of using a special office to include a wide variety of experts from different agencies and interest groups in the design of reform. Inclusion of multiple veto and proposal actors in deliberation tends to minimize opposition to reform, both within government and parliament.

Inclusion of non-governmental experts may be possible only if the special office for pension reform gains significant organizational independence from the government. Poland's special office was set up with such a political strategy in mind. The Office of the Plenipotentiary was established as an independent group of technical experts working under the direction of a head of office. A Plenipotentiary for Social Security Reform, separate from the head of office, acted as a political operative, conducting negotiations within the government and parliament and performing other political tasks relevant to reform, but not day-to-day technical operations. This model may prove useful for other states embarking on reform. Autonomy for a special office allows it to cooperate with partisan and interest group actors both within and outside of the governing coalition, and across all the different government agencies.

Using a special office as a deliberative mechanism may be more advantageous than using pre-existing public consultative bodies. Special offices could include a special advisory board, with wide representative functions, that would allow reformers a direct channel of communication with key actors in the reform process, in a forum that privileges the agenda-setting power of the special office. A special office can also organize conferences, special meetings, and exchanges of letters within the context of a well-defined public relations campaign.

In addition to providing a deliberative forum, special offices can also coordinate reform activities in the early implementation phase, and help to incorporate new actors into the pension reform process. Poland's Office of the Plenipotentiary played an important role in facilitating the establishment of the new pension fund regulatory agency, UNFE, and drafting additional laws and regulations. The political challenges of reform deliberation do not end with implementation. New actors are created in implementation, new interests spring up, and unforeseen regulatory challenges arise. Therefore a special office should be conceived as more than a design shop for the early stages of reform. It has an important role to play as a clearinghouse and deliberative forum for coordination among actors involved in the reform, including new ones created by implementation itself. Its life should continue through the first two years of implementation.

7.8.3 INTEREST GROUPS

The impact of interest groups depends on their relations to key veto and proposal actors, and on their capacity for anti-reform mobilization. Interest groups that elaborate their own proposals for reform should be consulted in the early planning stages, and, if possible, included in the composition of special offices for pension reform. Early inclusion will reduce the likelihood of opposition at a later stage, although possibly at the cost of changes in reform design. Section six presented numerous examples of concessions granted to interest groups in the reform process in Kazakhstan, Hungary, and Poland, showing that a wide variety of interest groups have been convinced to support fundamental reform. Some require selective incentives, while others agree with fundamental reform out of ideological conviction. New trade unions, for instance, generally support market reform and should be seen as potential allies in any fundamental reform effort. When concessions are necessary to avoid anti-reform mobilization, the World Bank should recommend concessions that satisfy interest groups' short term goals, while minimizing long-term effects on reform. A good example of this are the short-term increases in pension rates agreed to in Hungary in exchange for the adoption of half-price, half-wage indexation over the long term. Providing ways for interest groups to participate in second- or third-pillar pension reform business has also proven effective in Hungary and Poland.

7.8.4 WORLD BANK INTERVENTIONS

A comparison of World Bank interventions in Kazakhstan, Hungary and Poland showed the surprising impact of specific reform ideas. In Kazakhstan, reformers implemented a program of reform that included a mandatory, funded pillar without direct World Bank assistance in the planning stages. Reformers had read Averting the Old Age Crisis and attended World Bank conferences, and, together with advice from USAID, became convinced of these ideas. Similarly, Poland implemented a notional defined contribution first pillar largely because of the personal experience of the World Bank official designated to be head of the Office of the Plenipotentiary for pension reform. This official's belief in a notional defined contribution first pillar translated directly into policy in Poland. These two examples show that fundamental reform programs often reflect the specific reform ideas of key actors. Therefore, it seems that World Bank's role in generating reform ideas can be equally as important as its direct interventions. A key challenge for the future is for the World Bank to develop more systematic ways of

tailoring multi-pillar reform to specific local conditions. Some within the Bank have recently argued that private, funded systems may not be appropriate for countries with low levels of governance and regulatory capacity. Further research needs to be done to enhance knowledge about what types of reform are appropriate for different countries around the world. This and other new knowledge generated and disseminated by the Bank may have an independent effect on reform quality, above and beyond its impact on direct policy interventions.

7.8.5 TRADEOFFS ACROSS DELIBERATIVE FORA

Case studies show that reformers face tradeoffs across deliberative fora for negotiation with reform actors. One implication is that reformers should give careful attention to the fora in which fundamental reform is discussed. Given the close technical cooperation between the World Bank and special offices for pension reform, the possibilities of expanding the use of these special offices as deliberative fora should be explored. It may be possible in some cases to incorporate institutional and partisan veto actors and interest groups into discussions within a special office structure, for instance in an advisory body to the special office, and to use this as a means of disseminating information and reaching agreement with a wide range of actors. Deliberation in this more controlled forum could serve to replace the need for extensive deliberation in other bodies. We have seen that deliberation in parliament serves to enhance the power of partisan veto actors and their allied interest groups, and that deliberation in tripartite councils privileges the interests of trade unions. Similarly, deliberation within special office structures should enhance the ability of reformers to influence the course of negotiation.

7.8.6 TRADEOFFS ACROSS REFORM STAGES

Reformers also face tradeoffs across stages of reform. Inclusive negotiation at the commitment-building stage will require compromises in basic design, while exclusive negotiation will require more compromises at the coalition-building phase, and cause more resistance in implementation. Reformers need to make conscious decisions about which veto and proposal actors to include at each stage, while considering the potential costs of excluding any proposal actors, interest groups or potential future veto actors, particularly opposition political parties. Ideally, fundamental reform would be accepted by as wide a spectrum of interested parties as possible. Pension reform requires spontaneous mass compliance, and therefore any anti-reform mobilization is potentially dangerous. On the other hand, new reform ideas are inherently controversial and it may not be possible to convince alternative proposal actors to accept the basic premises of fundamental reform. Evidence from the three cases suggests that in commitment-building, reformers should endeavor to be as inclusive as possible, without sacrificing the basic objectives of reform. Groups with similar reform ideas should be consulted, and acceptable compromises reached. Alternative proposals should be incorporated, if at all possible. While negotiations at the commitment-building stage may result in substantial concessions, smooth implementation of reform is a necessary objective. Major reversals in the implementation phase can destabilize the system and undermine public confidence. This can have a direct impact on reform efficiency. The costs of compromise at the commitment-building stage need to be weighed off against the benefits of spontaneous mass compliance in implementation. In a major institutional change such as

fundamental pension reform, reformers who are cognizant of these tradeoffs will be prepared to manage a more efficient reform process.

8 APPENDIX TABLES

8.1 MAJOR CHANGES ACROSS STAGES OF PENSION REFORM PROCESS IN KAZAKHSTAN

	Commitment-building	Coalition-building	Implementation
First pillar	To be phased out	Unchanged	Unchanged
Contribution rate	Initial 10% contribution to be phased out over a ten-year period	Initial contribution rate increased to 15%; Phase-out period extended until death of last participant in state PAYG system	Unchanged
Pension age	Increased to 65 for both men and women	Increases stop in 2001 when age reaches 63 (men); 58 (women)	Unchanged
Special benefits	Special benefits eliminated	Lower retirement age for employees of “power ministries”; residents of top two nuclear radiation zones; and rural women with more than five children	Protests by miners, pilots, and steelworkers to reinstate special privileges; possible legislative initiatives
Eligibility work period	30 years	25 (men); 20 (women) years	Unchanged
Indexation	No automatic indexation	Regular price indexation	Unchanged
Minimum pension	Means-tested minimum state pension financed by central government budget; no automatic indexation	Unchanged	Unchanged
Switching	Mandatory for new labor force entrants	Unchanged	Unchanged
Disability pensions	Substantial reform	Unchanged	Unchanged
Second pillar			
Contribution rate	10% (employee)	Unchanged	Unchanged
Guarantees	No guarantees in private pillar	Guarantees for contributions to State Accumulation Fund, but not private funds	
Annuity payments			

8.2 MAJOR CHANGES ACROSS STAGES OF PENSION REFORM PROCESS IN HUNGARY

	Commitment-building	Coalition-building	Implementation
First pillar			
Contribution rate	Long-term target rate increased from 15% to 18% (employer); to be phased in over time	22% for those in new system; 30% for those in old; employee contributions capped at 2x average wage; employer contributions not capped	24% for those in new system; 30% for those in old
Pension age	62 for both men and women	Transition period agreed	Unchanged
Special benefits	Paid for by higher contributions in agreed occupations starting 1998	Paid for by higher contributions; system to be phased in by 2000	
Eligibility work period	35 years	20 years; more generous counting for university students, mothers	Swiss indexation implemented earlier
Indexation	From wage to Swiss indexation	Swiss indexation delayed until 2001; generous a priori increases	
Minimum pension	From no minimum pension to a means-tested minimum state pension financed by central and local government budgets	Minor changes in calculation of minimum benefit	
Switching	Mandatory switching for those 47 and under	Voluntary switch for current workers	
Disability pensions	Substantial reform	Reform delayed	
Second pillar			
Contribution rate	10% (employee)	6-8% phased in over two years	6% (employee)
Guarantees	Guarantee fund	State stands behind guarantee fund; will also guarantee annuities	
Annuity payments		Unisex tables for calculating benefits	

8.3 MAJOR CHANGES ACROSS STAGES OF PENSION REFORM PROCESS IN POLAND

	Commitment-building	Coalition-building: Phase 1	Coalition-building: Phase 2	Implementation
First pillar		Transition to Notional Defined Contribution (NDC) system	Unchanged	Unchanged
Contribution rate	Undefined	36% of gross wages or 25% of net wages; capped at 250% of average wage	Unchanged	Unchanged
Pension age	65 for both men and women	62 for both men and women with incentives to retire later	65 (men); 60 (women)	Unchanged
Special benefits	Elimination of most special benefits	Elimination of most special benefits; inclusion of military and railway workers; farmers' system unreformed	Bridging pensions arranged for certain categories of workers and those with acquired rights; judges excluded	Specific categories of workers and bridging arrangements negotiated
Eligibility work period	15-35 years	25 years	25 (men); 20 (women) (?)	Unchanged
Indexation	Price or wage indexation	Average living costs	Mixed price-wage formula with 20% share of wages	Unchanged
Minimum pension	Minimum pension of 20-30% of average wage; indexed	Minimum pension estimated at 28% of average wage; minimum work period req.	Unchanged	
Switching	Undefined	Optional switching for those aged 30-50	Unchanged	Unchanged
Disability pensions	Unreformed	Unchanged	Unchanged	Unchanged
Second pillar				
Contribution rate	Undefined	9% of gross wages or 6% of net wages	Unchanged	Unchanged
Guarantees	Undefined	Guarantee fund for bankruptcy; guaranteed relative minimum rate of return in private pillar	Unchanged	Unchanged
Annuity payments		Unisex tables for calculating benefits		
Third pillar	Undefined	New regulations for voluntary pension funds; New multiple-employer plans	Unchanged	Unchanged

For further description of the new Polish pension system, see Agnieszka Chlon, Marek Gora and Michal Rutkowski (1999), "Shaping Pension Reform in Poland: Security Through Diversity," World Bank Pension Reform Primer, Appendix tables 7 and 8, pp. 61-63.

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