

## **Statement to the Panel Ministry of Finance, Slovenia**

Future fiscal pressures arising from population aging are severe in Slovenia. Currently the pay-as-you-go system is undergoing parametric changes originated in the 1999 pension reform and the government is planning further modifications. Simultaneously, changes to the third pillar legislation are being considered which will aim at enhancing provision of services, transparency and encouraging private savings. Nevertheless, we are aware that further systemic changes are needed to ensure fiscal sustainability and at the same time adequacy of pensions.

We have been cautious with pension reform and its fiscal impact. One of the key concerns in the past was accession to monetary union and the fiscal stress deriving from systemic reforms beyond the important parametric changes in the pay-as-you go system. Now the reformed EU fiscal framework allows for temporary deviations of fiscal targets (4-year transitional period for fully accounting the impact of pension reforms) when addressing pension reforms that contribute to long-term fiscal sustainability. However, systemic changes need to be carefully designed to ensure appropriate burden sharing among existing and future pensioners and to avoid the re-emergence of contingent liabilities for the government once a reform has been passed due to choosing wrong system design. Such a risk can even hinder credibility and further possibilities of reform.

At the core of reforming pension systems in the region are payroll taxes and the consistent use of tax revenue within a consistent pension framework. While payroll tax (i.e. pension contributions) can be wrongly perceived as a tax it is important to ensure transparency regarding the links between the contributions and benefits. This should be the case in any type of reform. Obviously, it is preferable to carry out a reform within the existing levels of payroll tax rates. However, in countries like Sweden changes in the system were also accompanied by an increase in contribution rates. Again, all depends on the degrees of transparency and of burden sharing among generations. Similarly important is the appropriate use of tax revenue or tax expenses. Tax allowances can be perceived in some cases as part of the solution. But before introducing these, a precondition is to look at their consistency with the overall pension design and to assess the beneficiaries and the impact of the allowances. This is relevant taking into account that financial resources are already scarce and their opportunity costs very high.

It is also difficult to perceive a sustainable reform from financial and social point of view without changes in benefits. This implies the need of an intergenerational consensus among existing and future pensioners about burden sharing. In particular, the issue is how to create room in payroll taxes and current pension benefits for funding pensions of individuals who are currently in the labor force and the newcomers as they will to a large extent bear the heavy burden of low fertility rates and improvement in longevity.

The key to reform lies in providing transparency about pay-as-you-go system benefits, thus strengthening the link between contribution and benefits in pension systems. This is the key to reform in the sense that transparency can be established only if it is accompanied by reform measures that help diversify sources of income upon retirement and clarify elements of social insurance and welfare system. To this end, a shift to a notional defined contributions system or a shift to other forms of automatic stabilization provisions that adjust pensions to demographic changes without requiring political interventions can be helpful. In considering such changes, attention needs to be placed on magnitude of the resource distribution and risk implications. Such an alternative comparing to a partial shift to a defined contribution scheme has advantages in terms of risk and cost. In any case, this type of

systemic change has to be considered within a pension reform framework that delivers adequate and sustainable replacement rates.

It is difficult to perceive adequate replacement rates in the future without funding pension benefit. However, the fiscal impact has to be carefully assessed as well as the burden sharing among generations. As this type of changes pertain primarily to social security, if implemented its universal coverage should be ensured. Similarly, system design has to ensure that funds are managed efficiently and in a sound manner taking a view to their contribution to the wide-system replacement rate. Well functioning and competitive financial market in the segment of pension's accumulation and de-accumulation phases are an important pre-condition. Another key pre-condition is financial literacy. The absence of educated individuals can hinder reform and provision of adequate income upon retirement.

Extending working lives is the other key ingredient in reforming pension system. Changes in the pay-as-you go parameters can contribute to this end as well as the provision of financial incentives. Labor market reforms, aiming at increasing labor participation, can contribute to fiscal sustainability. Life long learning strategies are a key to this end as they aim at continuously equipping the labor force with the necessary skills to maintain employment. However, we have to be careful in their design as they can involve the use of scarce resources or entitle reduction in government revenue for example as a consequence of reduction in payroll taxes. Labor market reforms can help to make the overall economy resilient to changes in economic environment but can also add to the challenge of coverage in funded systems which should be born in mind when designing changes. Overall reforms should provide a certainty as to the expected income upon retirement, encouraging desirability of work and ensure sustainability of system in an increasingly integrated labor market in the EU.

Probably the way to proceed in the reform process is to involve the stakeholders and widely inform the public opinion about the challenges and their likely solutions. In particular, the population should be acquainted with existing and future benefits. A precondition to reforms in this case is a well conceived set of policy measures to which the current panel and pension forum might be helpful.