Trends in social cohesion, No. 2

Trends and developments in old-age pension and health-care financing in Europe during the 1990s

Council of Europe Publishing
Editions du Conseil de l'Europe

The social security financing mechanisms of the member states of the Council of Europe faced a series of common challenges during the 1990s, one of the most significant being the rapid ageing of the population. This second volume of "Trends in social cohesion" focuses upon the common solutions developed to these challenges and concludes with a series of common concepts which are relevant to health care and pension financing. These include improved efficiency, enhanced individual responsibility, increased competition and sustainability.

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On 11 October 2001, he was called to the English Bar and takes great pride in his membership of the Honourable Society of Gray's Inn.

Trends and developments in old-age pension and health-care financing in Europe during the 1990s

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The opinions expressed in this work are those of the authors and do not necessarily reflect the official policy of the Council of Europe or of the Secretariat.

Printed in Germany

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Foreword

The Council of Europe, as an international organisation devoted to the promotion of basic values and human rights, has defined one of its major goals to be the promotion of social cohesion in all its member states.

In its strategy for social cohesion, which sets the agenda for the Council of Europe in the social field for the coming years, the European Committee for Social Cohesion (CDCS) emphasises that social security systems are one of the most powerful institutional expressions of social solidarity, and that at a time when many questions are posed about their future development and financing, any social cohesion strategy must therefore have as a main aim the strengthening of social security systems. For this purpose, CDCS has instructed the Committee of Experts on Standard Setting in the Field of Social Security (CS-CO) to observe pan-European trends and developments in the social security field and prepare, for its attention, information on current issues.

Mr Jason Nickless has prepared a report for the CS-CO committee, which was forwarded to the CDCS for information, summing up trends and developments in the way that social protection systems in the member states of the Council of Europe financed their old-age pension and social health-care schemes during the 1990s. In an annex to the report, Mr Nickless makes some predictions about old-age pension and health-care financing in the future.

Mr Nickless was able to single out certain trends and developments with a potentially adverse impact upon the fundamental principle of solidarity and social cohesion which the European social security model bases itself on.

As a result of a debate on consequences and challenges for social cohesion of current trends in social security at its seventh meeting (14-16 November 2001, Strasbourg), the CDCS decided to reflect on how to implement the social cohesion strategy and adapt it to the new challenges.

A first step in 2002 will be a debate within the CS-CO committee on different experiences resulting from recent old-age pension reforms, in particular in the central and eastern European member states, but also in the member states of the European Union.

This is the second issue in the series "Trends in Social Cohesion" launched by the Directorate General III Social Cohesion in order to provide a forum for observation and analysis of the developments taking place on matters of social cohesion in the Council of Europe member states.

Strasbourg, 25 January 2002

Gabriella Battaini-Dragoni

Director General of Social Cohesion
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Introduction

This report concerns trends and developments in the way that social protection systems in the member states of the Council of Europe have financed their old-age pension and social health-care schemes during the 1990s. It is primarily concerned with the financing of statutory compulsory social protection schemes. In other words, schemes where the state makes membership compulsory and controls the conditions of entitlement and the amount of benefit. Reference is occasionally made to private supplementary insurance, provided either through occupational or individual schemes, but this is only done in order to illustrate its impact on the financing of the compulsory statutory system. Voluntary insurance schemes, whereby those who are not covered by compulsory statutory social insurance can join the compulsory scheme of their own volition, are also mentioned but only with regards to their effect on the financing of the statutory compulsory schemes.

This report relies upon a wide definition of "financing" and investigates not just the trends and developments relating to the collection of social protection revenue, but also the efforts made by states to ensure a balanced and sustainable social protection budget. The trends in the financing of old-age pensions and health-care are dealt with in separate sections. Each section begins by looking at the various financing problems that have been faced by the member states of the Council of Europe between 1990 and 1999. It then moves on to describe the ways in which these states have responded to their common problems and isolates a series of trends and developments. Occasional references have been made to Canada and Australia; these states have Observer status within the Council of Europe and feature in many of its publications on social security. Although this report is concerned with trends in Europe, examples are sometimes provided from these two Observer states where they represent a particularly interesting or clear illustration of similar developments to those within Europe.

The report concludes with a list of common concepts that have been used in both the old-age pension and social health-care fields in order to overcome the financial challenges posed to all the Council of Europe member states during the 1990s.

CHALLENGES FOR OLD-AGE PENSION FINANCING IN THE 1990s

The social, political and economic developments of the 1990s created challenges for all the social security systems covered in this report. These challenges can be broken down into three basic types; those principally effecting western European countries, those impacting upon countries in transition in central and eastern Europe and finally those faced by both groups of countries alike.

Challenges facing western European countries

Most western European states began the 1990s feeling the bite of economic recession, increased unemployment, falling gross domestic product and growing demands for social expenditure. Members states of the European Union faced the additional burden of fulfilling the strict conditions for European Monetary Union, which called for considerable reductions in inflation and public deficit.

Challenges faced by countries in transition in central and eastern Europe

For many nations in central and eastern Europe, the 1990s marked the beginning of a new era of independent democratic governments and the birth of market based economies. With these monumental transitions came privatisation and the pressure of market forces. The result was wide spread downsizing and rationalisation of previously state-run businesses, which in turn resulted in increased unemployment. The early years of the new market economies were also dogged by rapidly growing inflation as control over the prices of essential goods was relinquished to the invisible hand of free market economics.

Challenges faced by both groups of countries alike

Nations right across Europe have had to cope with similar problems throughout the 1990s. One such problem was the growing difference in numbers between the economically active population and the economically inactive population. All the social security systems under consideration in this

report are to some extent based on the principle that the active population should finance the social benefits of the inactive population, a system often referred to as "Pay As You Go" (PAYG). During the 1990s, it became clear that the number of people over retirement age was growing and would continue to do so well into the next millennium. Furthermore, the economic pressures encountered at the end of the boom in the 1980s, that continued into the beginning of the 1990s, led to high levels of unemployment, often long-term unemployment. All this, combined with the increasing number of people of working age engaged in higher education and full-time study, led to a significant strain on the active population in its financing of the inactive one. Fears about the sustainability of social security financing systems were further enhanced by the pressures stemming from changes in family structure, the necessity to ensure adequate benefits for the whole population and the need to ensure greater equality between men and women. States all over Europe thus faced similar problems and the analysis below shows how these problems were dealt with using similar solutions.

Trends in old-age pension financing in the 1990s

This section isolates nine essential trends in the organisation of pension financing in the member states of the Council of Europe between 1990 and 1999. These trends are based on the motivation behind the development of social security law during this reference period.

1. Reducing the amount of benefits

With the rapid growth of the inactive population, especially amongst the elderly, it became increasingly difficult to balance the income and expenditure in the old-age pension budgets. Benefits were sometimes reduced by direct cuts introduced by law or regulation. In 1994, Denmark reduced the basic amount of the National Pension from 47 784 to 44 328 Danish kroner per annum. Other states reduced elements in the pension calculation formula, for instance Sweden temporarily reduced the basic amount for pension calculation by 2% between 1993 and 1998, resulting in a real reduction in the amount of benefit. In 1994, the percentage of reference earnings used to calculate private sector employment pensions in Finland was reduced from 1.8% per year of employment to 1.5%. A similar reduction in the calculation process took place in Portugal in 1994, where the previous earnings used to determine the old-age pension fell from 2.2 to 2%. Norway also reduced the amount of previous earnings taken into consideration when calculating its supplementary pension. Cuts and reductions were made to pension supplements paid in respect of spouses or children ; this occurred in Greece, Portugal, Liechtenstein and Finland. In some cases the supplements were gradually phased out, as in Finland, where no new supplements to the national pension were paid after 1 January 1996 – the supplements that had been granted before this date were then slowly reduced to nothing. The supplements paid for spouses were cut by 20% of the original amount every year from 1997 until they ceased in 2001, the child supplements were abolished in the same fashion between 1998 and 2002.

Benefit levels can be reduced in real terms by ensuring that regular readjustment or indexation is below the level of inflation. This method was used by several states in the early 1990s, including Finland, Hungary and Spain. A similar means by which to control the real level of benefits is to

freeze benefit levels and apply no indexation or adjustment at all. This approach was adopted in Italy in 1993 and Austria in 1997, although a system of supplements to low income Austrian families was implemented in order to avoid excessive hardship. In Germany, the relative value of pensions was reduced by a fundamental reconsideration of the adjustment process. Before 1999, pensions in Germany were maintained at a level of 70% of the average wage, over the thirty years following this date this yardstick will be reduced to 64%. This has been called the "demographic co-efficient" as it is hoped that this long-term adjustment will ease the impact of an ageing population on pension financing. Latvia also reduced the financial pressure on its budget by changing its process of indexation, reducing the frequency of adjustment from every quarter to every six months. This reduced administration costs and meant that pensions lagged behind the real value of goods and services for a slightly longer period.

Finland, Greece, Italy, Latvia and Portugal have used variable indexation in order to reduce the real value of benefits for those with higher pensions. In some countries, this has been done by simply not adjusting pensions over a set level. Whereas other countries such as Italy and Greece have developed a series of thresholds, with the pensions at the lowest level receiving higher rates of adjustment which are then gradually decreased for higher pensions. In 1995, Italy introduced the following mechanism for annually adjusting pensions : the indexation was based on any increase in the cost of living. Those with a pension of up to twice the minimum pension would receive an increase equal to 100% of the development of the cost of living. Those receiving a pension of between two and three times the minimum would receive 90% of this amount and those pensions exceeding three times the minimum would only be adjusted by 75%. This has the effect of reducing the real value of benefits but also ensuring a redistribution of income.

Indexation is therefore a powerful tool by which to control the real level of benefits, especially in those central and eastern European states where inflation is particularly high. However, it is not always applied in a consistent and transparent manner. Examples taken from the Baltic states illustrate the dangers of erratic and uncontrolled adjustment mechanisms. In 1998, elections were due in both Latvia and Estonia and the central governments in both states decided to use the indexation process to considerably increase the amount of old-age benefits. In both cases, this forced the pension budgets from surplus into deficit. In 1996, Poland introduced a new method for adjusting old-age pensions which considerably increased political discretion in determining pension increases.

The options for adjustment of pensions are quite considerable. Indexation can be backward looking and based on economic changes that have already taken place or it could be forward looking and rely upon economic forecasts. It could be based on changes in retail prices or it may decide to allow pensioners to share in productivity increases by linking benefits to wages. It is even possible to have a weighted system that reflects changes in prices and developments in wages. The important thing is that indexation should be transparent and consistent in order to allow legal certainty and reflect the economic situation rather than the political one. The importance of indexation is already recognised to some extent in the Council of Europe's revised European Code of Social Security,[1] (hereinafter "the revised code"). The revised code explains that benefits must be reviewed under prescribed conditions in order to follow any appreciative changes in the general level of earnings or cost of living.[2] It does not however demand transparency, consistency or political impartiality and neither does it recommend any particular structure for indexation.

Pensions that are linked to previous earnings may be reduced by extending the reference period prescribed for determining the average wages that are used in the pension calculation. Wages are usually much lower at the beginning of a person's career compared to their wages in the final years before retirement. Thus by increasing the reference period from 8 years to 15 years, as happened in Spain in 1997, periods of lower wages will be taken into account and the overall average will drop. This method of pension reduction has been used in Albania, Austria, Canada, Finland, France, Hungary, Poland, Portugal, Spain and Turkey. However, despite the widespread trend of increased reference periods, the actual periods taken into account in the various countries still differ considerably, from five years in Canada to twenty-five years in France.

Many countries operate a number of different schemes to cover the risk of old-age for different professional groups. It is quite common to have separate schemes for workers in the public sector and workers in the private sector. The harmonisation of these numerous pension schemes has been used to remove special benefits given to particular groups. For example, the new harmonised pension scheme introduced in Italy in 1998 removes

1. The document attempts to make some forward looking suggestions on the future of international standards and for this reason is based on the most up-to-date version of the code, even though the author appreciates that this version is not yet in force.
2. Articles 71(12) and 72(10) concerning the level of benefits.

the special privileges previously afforded to airline pilots, sports persons and those working in the entertainment sector. The removal of these privileges effectively reduces the costs of the benefits. Harmonisation between various pension schemes has taken place in Portugal, Romania and Croatia. However, harmonisation is not always used as a means to reduce benefit ; for example, the harmonisation of the Greek farmers' scheme in line with provisions provided in urban areas substantially improved the position of agricultural workers.

2. Increasing contribution revenue

As well as reducing the flow of money going out, old-age pension budgets can also be stabilised by increasing the amount of money coming in. Below are some examples of how states have sought to increase social revenue during the 1990s.

Austria, Canada, Finland, Greece, Germany, Cyprus, Iceland, Malta, Spain, Italy and the Netherlands all directly increased the amount of social contributions. For example, Germany increased total employer and employee contributions from 17.5% of gross pay to 19.2% gross pay in 1994. Some of the most significant increases occurred in the Canada Pension Fund where the contribution was raised every year from 3% of gross earnings in 1994 to 9.9% in 2003 ; this contribution is split equally between employers and employees. Reference is made to this example because the Canadian Government explained that, according to demographic projections, imposing these increases sooner rather than later meant that no further increases will be required until 2038, whereas if contribution rates had not been raised in this way, the contribution would have evened out at around 14.2% in 2016.

The increased pressure on social financing has meant that new social security employee contributions had to be introduced in Finland, Greece (for civil servants) and Bulgaria.

Countries right across Europe have made an effort to improve the collection of contributions in order to increase revenue. This has been achieved in many different ways. One example of better contribution recovery is improved data collection and processing. This has involved increased use of computerisation in Cyprus, Portugal, Poland, Spain, Belgium, Turkey, France, Greece and Italy. Enhanced collection of contributions has also been achieved by better co-ordination and data sharing between the various

bodies and organs responsible for taxation, social security, local governance, etc. Procedures for enhanced co-ordination have been established in Italy, Spain, Albania, the United Kingdom and the Netherlands. This has been taken one step further in Italy, Latvia and the UK where the bodies responsible for the collection of social contributions have either been merged with or replaced by the tax authorities. This is believed to increase efficiency, improve data processing and enhance customer relations as clients now have a single point of contact for all payments. In fact, the system in Italy allows people to offset money owed to them by the state as regards taxes, with money they owe to the state with regard to social security contributions and vice versa.

Contribution collection has also been improved by increasing the rate of interest applied to late payments by employers, as was the case in the Czech Republic on 1 January 1997, where interest was increased from 0.025% to 0.5% per day. Of course, establishing interest at a daily rate, as opposed to a weekly or monthly one, may make employers more conscious of the need to pay quickly as they are given a clear picture that every day counts.

Major efforts have been made in many states to combat fraud in order to ensure fuller flows of contributions in and more restrained flows of money out. Fraud committed by employers when they evade payment or full payment of their contributions, by failing to declare their employees or lying about how much their employees are actually paid, naturally reduces revenue to the social protection system. Employees who defraud the social security system by claiming benefits whilst at the same time performing undeclared paid work are a drain on the social protection system as a whole and on the old-age system in particular because these people are not paying pension contributions themselves or having contributions paid by employers on their behalf.

One means of fighting fraud is increased institutional co-operation ; whereas it might be easy to deceive one public body, it is more difficult to maintain a consistent lie to more than one organisation. Increased interinstitutional co-operation has been used to identify fraudulent employers in Italy, Spain, the United Kingdom, Germany and Portugal. For example, in Portugal, an agreement was signed in 1997 between the tax authority, the Labour Inspectorate and regional social security bodies in order to enhance each organisation's ability to track down violations of its respective regulations.

The fines for non-payment of contributions have been increased in Turkey, Belgium and Italy. A new administrative procedure has been introduced in Croatia whereby first instance decisions about employer evasion of

contributions are taken by an executive body instead of the courts. This increases the speed of the decision-making process, reduces administrative costs and frees space in court.

New investigative bodies have been created in the United Kingdom, Denmark and Greece. These are given extensive powers to conduct inspections and spot checks on businesses. The UK has gone one step further by encouraging members of the public to report those who are committing benefit fraud. This can be done over the telephone by contacting the National Benefit Fraud Hotline, which was opened on 5 August 1996 and accompanied by extensive advertising on television, in newspapers, on posters and over the radio.

Contribution evasion by employers and employees is a particular problem in central and eastern Europe. The transition from a centrally planned economy where a majority of companies were directly operated by the state, to a privatised market economy with independent profit-motivated employers makes it much harder for state organisations to monitor contribution collection. The growing "informal" sector, where employees earn money that is not declared to the authorities, is a real cause for concern in central and eastern Europe. It is therefore quite likely that anti-fraud campaigns will soon be developed in central and eastern states and that these states will be looking at the examples set by the West.

The revised code explains when benefits may be suspended or withdrawn[3] and how such suspension or withdrawal may be appealed before an independent tribunal.[4] However, there are no standards concerning the investigation of social security fraud. This is, of course, an area that touches upon the civil and political rights enshrined in the European Convention on Human Rights and particularly one's right to privacy.[5] Nevertheless some consideration should be addressed as to whether further guidance is required for the investigation of social security fraud.

3. Ensuring sustainable financing

Measures have been taken by states in an attempt to reduce the immediate and projected long-term pressure placed upon PAYG systems by the ageing population and by fluctuating levels of unemployment.

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3. Article 74.
4. Article 75.
5. Article 8, European Convention on Human Rights.

Croatia, Finland, France, Germany, Poland, Hungary, Luxembourg, Portugal and Spain made some attempt, during the 1990s, to create pension fund reserves in order to act as buffers against fluctuating economic cycles and protect against the predicted impacts of the ageing population. It is hoped that these funds can be relied upon during periods of recession so as to avoid increasing labour costs by raising employer contributions and/or reducing consumption by increasing employee contributions or taxes. These funds may thus go some way to preventing the downward spiral caused by rising unemployment, which in turn results in increased expenditure on benefits and reduced income from contributions, which then places pressure on the state to increase social contributions and taxes, which finally leads to drops in consumption and further unemployment.

Some states have introduced funded elements to their compulsory pension schemes in order to take the pressure off the current system of PAYG. This has been more common in central and eastern Europe, where funded elements have been introduced to compulsory old-age insurance schemes in Latvia, Hungary and Poland. A similar system has also been introduced in Sweden following radical reforms to its pension system in 1999, where 2.5 percentage points of the compulsory 18.5% old-age pension contribution is placed into a personal fund for the employee and used to finance a periodic benefit upon that person's retirement.

The World Bank has actively promoted the movement from PAYG financing to fully-funded financing mechanisms. It is actively encouraging "developing nations" in Asia, central and eastern Europe and both Central and South America to create a "funded system" roughly based on the model adopted by Chile in 1980.

The original Chilean pension system was established in the 1920s is based on PAYG principles and is divided into different schemes for various professions. In its early years, small numbers in the aged population group and low unemployment led to surpluses that, in turn, led to unsustainable increases in benefits. It soon became clear that the demographic situation could not maintain sufficient benefit levels. In 1955, there was one pensioner for every 12.2 active persons whereas by 1980 this had fallen to just 2.5 active persons for every pensioner.[6] The Chilean authorities had little choice but to increase contributions but this only resulted in increased contribution evasion. Rising evasion was also attributed to the inadequate link between benefits and lifetime contributions, the amount of benefit was typically determined by political pressure exerted by the individual schemes, and so there was little incentive to pay increasing contributions.

6. "The Chilean Pension System", OECD Working Paper, Vol. VI (1998), No. 26, p.6.

The new Chilean pension system is based on a centrally-funded element. This fully-funded pension is managed by private institutions known as Administradoras de Fondos de Pensiones (AFPs). These private bodies maintain individual accounts for each participant, which are invested according to a strict regulatory framework that is designed to reduce risk. In 1998, employees paid a total of 13% of their gross earnings to finance their old-age pension and to cover them in case of disability. When a person retires, the money accrued in his personal account (and enhanced through supervised investment) is either used to purchase a life annuity or to provide regular periodic withdrawals. Should the pensioner who elects the periodic withdrawals live longer than expected, he is given a tax-financed minimum pension ; should he die prematurely, the money left in his individual account may be passed on as inheritance. If a sufficiently large account has been saved over the pensioner's working life, a lump sum payment upon retirement may also be made. The administrative costs of running the scheme are deducted when the AFP calculates each pensioner's closing balance. All pensioners are guaranteed a tax-financed minimum pension in the event of their funded benefit falling below a set amount.

Complete freedom of movement is guaranteed between AFPs to ensure real competition as regards investment returns and administrative costs. One of the problems facing the second pillar is that, although 99% of the working population has joined an AFP, only about 59% of the working population in 1996 actually made contributions. The others failed to pay into their capital accounts, raising questions about the actual incentive of a greater link between benefits and contributions and the moral hazard of a guaranteed minimum pension.

Completely voluntary individual savings and pension insurance coverage is also available. The AFPs encourage private savings by offering tax-favoured voluntary accounts that run along side the individual's funded pension account.

Although the Chilean system eases the burden of an ageing population, improves the link between contributions and benefits as well as considerably reducing the total employee contribution, it has involved costly transitional measures. The state has had to finance the pensions of those already entitled to PAYG pensions before the reform entered into force. Furthermore, the government had to compensate workers who had already spent possibly many years contributing to the old system ; this was done by depositing "recognition bonds" into the individual accounts of these older

workers. These bonds provide a real return of 4% of the credited amount which is based on 80% of the worker's salary between June 1978 and June 1979, weighted by the number of years of contribution over the age of 35. The recognition bonds are cashed in when the worker retires. The Chilean Government financed these transitional measures from a budgetary surplus of 5.5% of GDP that had been saved over the five years preceding the introduction of the new system.

The World Bank has actively promoted funded systems in central and eastern Europe[7] and has had some obvious influence in Latvia, Lithuania, Estonia, Albania, Georgia, the Czech Republic, Hungary, Poland and Kazakhstan. The model promoted by the World Bank is a three-pillar system that is slightly different to that adopted in Chile. The first pillar is based on a mandatory, publicly run PAYG defined benefit system that is financed by social security contributions and provides a safety net benefit. The World Bank has expressed a preference that the first pillar should be based on means testing and only paid to those in need. The second pillar should be fully-funded and, preferably, managed by private bodies. Contributions to this pillar will be compulsory. Finally, the third pillar represents private, individual insurance promoted by tax policies and supervised by the state.

The influence of the World Bank began in central and eastern Europe by encouraging the revamping of the PAYG system in order to enhance the link between contributions and benefits. This enhanced link is thought to encourage the payment of contributions and tempt workers out of the informal sector. An example of this enhanced link may be found in the pension reforms of Latvia in 1995. The PAYG system continues to finance the pensions of the inactive population but a system of individual capital account recording has been introduced. So even though the money is actually used to pay those already in receipt of a pension, the state keeps a record of what each worker has contributed to the system. Each worker's "account" is regularly indexed according to increases in wages and the individual is sent an annual statement indicating how much they have "saved" so far. The system whereby people were given credited periods for raising children or completing military service was abolished and replaced by a fixed contribution that is paid on their behalf by the state into their individual "capital account" for these periods of economic inactivity. When the workers of today retire, their benefit will be equal to

7. Elsewhere it has supported the adoption of fully funded pension schemes in Colombia (1993), Argentina (1994), Peru (1995), Uruguay (1996) and Mexico (1997).

the final sum in their capital account divided by their anticipated life expectancy. This system offers some protection to lower paid employees through a guaranteed minimum pension.

The next stage of the World Bank's agenda for central and eastern European states is the development of a three-tier pension system with a fully-funded compulsory second tier. One of the principle advantages advocated for the introduction of a compulsory funded pillar is that, rather than using the revenue from contributions to finance current pension benefits, money can be invested thereby boosting capital markets, infrastructure and economic growth. Nonetheless, moving from a PAYG system to a funded one is expensive. The disadvantages of a funded system involve the close links between a worker's future and the capital market as well as the risk of embezzlement and potentially high administrative costs.

Compulsory fully-funded second pillars have already been put in place in Hungary, Latvia and Poland. Other states such as Lithuania and Latvia have already taken definite steps towards the creation of such schemes. The Hungarian system entered into operation on 1 July 1998 and is compulsory for all labour market entrants after that date. Those insured before this date have the option to join the funded system. In Hungary, those affiliated to the new scheme pay 2% of their gross wages into the downsized, first pillar PAYG system and 6% into an individual account. When the worker retires, he uses the accumulated capital to purchase one of a number of different annuities. Workers who have acquired insufficient funds for the purchase of an annuity are provided with a lump sum and a minimum pension ; whereas those with capital accounts containing more than enough to pay for their pension are given a lump sum from the excess funds.

This development of compulsory, funded pensions raises some interesting issues as regards social security standard setting. First of all, there could be some conflict with the revised code. For example, Article 76(1) states :

> "The cost of benefits provided in application of this (revised) code and the related administrative costs shall be borne collectively in such a way as to prevent hardship to persons of small means and take account of the capacity of the persons protected to contribute."

The introduction of mandatory funded pensions is a step away from a "collective" system and a definite movement towards an individual one. Furthermore, workers with "small means" will accumulate a much lower capital account. If these workers are unable to finance a proper pension,

they will be forced to live on a minimum pension (and possibly a lump sum paid upon retirement). This will be the case regardless of how many years they worked and could represent a real threat to solidarity.

Compulsory funded pensions developed under the World Bank model may also conflict with Article 77(1) of the revised code that states :

> "Where the administration is not entrusted to a public service responsible to an elected assembly, representatives of the persons protected shall participate in the management, or be associated with it in an advisory capacity, under prescribed conditions ; national legislation may likewise provide for the participation of representatives of employers and of public authorities".

Article 77(2) explains that the only exception to this rule concerns voluntary supplementary schemes. Where does this leave the "private companies" envisaged by the World Bank as the administrators of the compulsory funded pension pillar ? Can the representatives of insured persons really be expected to alter the behaviour of competing pension funds ? How much influence should these representatives have on vital decisions in areas such as investment policy ?

A great deal of regulation is required by the state before a second pillar-funded pension can be established and perhaps states would benefit from some guidance on an international level on this matter. Rules have to be developed concerning the risk factors in investment programmes. What sort of financial products can be purchased and in what proportions ? How much of the fund can be invested abroad ? If the funds are to be run by private bodies, rules must be established concerning which firms can provide the service, how the service should be regulated and what happens if a private firm becomes insolvent.

Finally, many states have attempted to use "alternative financing mechanisms" in order to switch their sources of funding away from the traditional social security contributions or social taxes paid by employers and employees. These mechanisms were intended to ease the pressure on the active population. Taxes that have been earmarked for social protection funds have been introduced on alcohol (France), tobacco (Belgium and France), the profits from pharmaceutical companies (Belgium) and car insurance premiums (France) as well as company cars (Belgium) and other employee fringe benefits (Spain). The most popular source of earmarked tax is on value added tax (VAT, a consumer tax) which has been used in Finland, Switzerland and Portugal.

As was mentioned above, Article 76(1) of the revised code states that social security benefits should be financed in "such a way as to prevent hardship to persons of small means and take account of the capacity of the persons protected to contribute". The search for alternative financing is becoming increasingly focused upon VAT and other indirect consumption taxes. Increasing these taxes only results in higher prices. The proportional impact of higher prices, especially for "pseudo-necessities" such as alcohol or tobacco, is greater for low-income households than for those with more income. Unless consumption taxes are focused on luxury products, their ultimate effect is regressive and therefore likely to create "hardship to persons of small means".

During the 1990s a number of "solidarity payments" were also introduced. These are payments that are levied on individuals and cover all their income, not just earnings from work but also income from property, shares and winnings. By extending the range of taxable income in this way, revenue may be considerably increased. Taxes of this kind were introduced in Belgium, Denmark and France.

Ireland earmarked most of the proceeds from the privatisation of its state telecommunication company in order to provide an alternative source of finance for its pension system. This method has also been adopted by states in central and eastern Europe where extensive privatisation took place throughout the 1990s.

4. Extending periods of active employment

The longer people remain economically active, the longer they pay contributions. By extending periods of employment, revenue is increased and expenditure on benefits is reduced. Encouraging people to work longer therefore reduces the pressures of an ageing population.

One way of ensuring that people work longer is to increase the pensionable age. The pensionable age has been increased in two basic ways. The most popular means was to equalise the pensionable age for men and women by increasing the pensionable age of women to match that of men. This has taken place in Austria, Belgium, Germany, Hungary, Lithuania, Liechtenstein, Portugal, Switzerland and the United Kingdom. In Latvia and Estonia, the pensionable age was equalised but was increased for men as well as women. Only in Liechtenstein was the pensionable age of men reduced, where it was lowered from 65 to 64 years whilst the female

pensionable age was increased from 62 to 64. Although most states are now opting for pensionable ages of around 65 years, the transitional periods over which pensions are gradually increased and the degree of warning given to workers who are rapidly approaching retirement vary considerably. For example, in Hungary, the retirement age of women was increased from 56 years in 1995 to 60 years in 2003. Whereas in Austria, the pensionable age set for women will increase by five years between 2024 and 2033. Many central and eastern European states have planned to increase their pensionable ages, however, the precise plans for how this increase will take place are not always consistent. For example, the pensionable age in Latvia on 1 January 1996 was 60 years for men and 55 years for women. As from this date, the pensionable age was supposed to increase to 60 years for women by 2004, but by 1999 it was decided that the pensionable age for both sexes should be increased steadily until it reaches 62 years in 2003 for men and in 2009 for women. This rather complex procedure could have caused some confusion amongst the older population had Latvia not embarked upon an extensive publicity campaign.

Another method of extending pensionable age was simply to leave any differences between men and women more or less intact and increase both pensionable ages. This was done in Albania, the Czech Republic, Lithuania, Moldova, Italy and Romania.

Pensionable ages in central and eastern Europe are generally lower than those in the West and will inevitably have to be increased in order to sustain viable old-age pension systems. It is very likely, given the demographic pressure placed upon pension financing mechanisms, that even those states which have already increased their pensionable age may well have to do so again in the not-too-distant future. If pensionable ages do have to be increased, it is important that this is done gradually in order to avoid uncertainty and allow people to plan for their future. The revised code sets standards for the organisation and level of pensions but does not provide any guidance on the gradual alteration of long-term benefits.

People can be obliged to work for longer by extending the qualifying period required before a pension is granted. This qualifying period may be based on years of employment, years of contribution to the old-age pension fund or years of residence. The qualifying periods required for a pension were increased for some or all of the population in France, Greece, Hungary, Latvia, Lithuania and Italy. However, the extent of qualifying periods continued to vary from one state to another. For instance, the qualifying period

for a partial pension in Hungary was increased from ten to fifteen years of employment in 1994, and in Latvia from five to ten years in 1996. The period required for entitlement to a full pension was increased to forty years for private sector workers in France, compared to thirty-five years for the same category of workers in Italy.

Efforts were made in many states to discourage early retirement. For some countries, this represented a distinct policy reversal as they had actually encouraged early retirement at the end of the 1980s in an attempt to reduce high rates of unemployment.

Pensions are reduced by a set percentile if they are claimed early in Austria, Croatia, the Czech Republic, Estonia, Latvia, and Slovenia, while the age limits for entitlement to an early pension were increased for some or all of the people in Belgium and Germany. The necessary contribution period for an early pension was increased in Austria and Denmark.

People may be discouraged from retiring early by adjusting the calculation method of normal old-age pensions. This was done in Austria where periods of insurance acquired in later life (after thirty years of employment for instance) are given greater weight in the calculation of the pension amount.

Italy attempted to restrict the costs of early pensions by suspending entitlement to them between 1992 and 1995. Denmark tried to reduce claims for early pensions by offering tax incentives for those who would be entitled to an early pension if they remained in work.

The size of the active population can also be maintained by encouraging people to defer their claims for an old-age pension and effectively work beyond pensionable age. One of the most common methods of encouraging deferment was to add a percentile bonus to the old-age pension for each year, month, etc., that the claimant works beyond pensionable age. This method was used in Albania, Austria, Bulgaria, Cyprus, the Czech Republic, Denmark, Germany, Hungary, Italy, Liechtenstein, Luxembourg, Norway, Poland, Slovenia, the Slovak Republic, Sweden, the Russian Federation, Romania, Turkey and the United Kingdom.

In Latvia the maximum limit on periods of contributions taken into consideration in the normal pension formula was abolished in 1995 – it previously stood at thirty-eight years. This integrated incentives to encourage people to continue employment into the pension formula itself. A similar method was used in the Czech Republic and in Austria where the years of contributions in later life were given increased weight when determining the amount of pension.

Australia introduced a lump sum bonus for those who did not claim their pension immediately. As from 1 July 1998, people who defer retirement will be granted 9.4% of their basic pension entitlement for each year of deferment up to a maximum of five years. This amount is then paid as a lump sum when they finally decide to retire (subject to a maximum of 47% of annual pension entitlement).

Introducing and promoting part-time pensions, whereby people reduce their working hours and in return receive a fraction of their pension, reduces the strain of benefit payment on the pension system and ensures that contributions continue to be paid. Part-time pensions also allow people to gradually adjust to retirement whilst training and passing on their valuable experience to those who will eventually replace them.

Part-time pensions have been introduced in Austria, Belgium, Denmark, Finland, France, Norway, Italy, Slovenia, Spain and Sweden. The taking up of the pension has been encouraged in a number of ways. In Finland, the age-limit for part-time pensions was reduced from 58 years to 56 years from 1 July 1998 and in Norway, the amount by which the pension was reduced was lowered from 50% of income from work to 40%.

Most of the European pension schemes that are based upon periods of economic activity will provide some type of credit to claimants for periods of economic inactivity, due to child raising, education or unemployment, for example. These periods will be used to determine whether or not the claimant satisfies any minimum periods of insurance membership for entitlement to the pension and may also effect the amount of benefit paid. One means by which to ensure that people remain in active employment for longer is to reduce credited periods, meaning that they have to work longer in order to fulfil their qualifying obligations. Credited periods have been reduced with respect to periods of study in Austria, Germany, the Czech Republic and Hungary. For example, between 1996 and 1997, Germany reduced the maximum number of credited periods for study from seven years to three years, allowing people to make retrospective contribution payments for any years of study beyond the maximum. However, credited periods have been increased in some countries in order to fulfil social goals such as the realisation of the equal treatment of men and women. Indeed, Germany increased its credited periods for time spent caring for a helpless relative (a task usually undertaken by women) and Luxembourg increased its credited periods for those bringing up children (a task that is again typically associated with women). In Switzerland, in order to take account of the years during which an insured person has exercised parental

authority over a child or has taken care of a disabled member of his or her family, education and care subsidies have been introduced as notional income included in the income used as the basis for calculating the pension

5. Actively promoting employment

Some states have used social security contributions to change the employment behaviour of employers. Reductions in social security contributions have been offered to employers who employ people from target groups such the long-term unemployed, apprentices and first-time job seekers in Belgium and Spain. In Belgium, these reductions have been used as an important tool in active employment policy, not only to encourage the employment of targeted groups of individuals but also to encourage more ambitious employment projects such as the reduction of working time. Complete exemptions from employers' contributions have been granted to employers who take on the long-term unemployed, low earners and first-time job seekers. For example, in the United Kingdom, employers were granted a one-year holiday from the payment of National Insurance Contributions for each employee engaged after two years of unemployment. These measures of active employment have a number of impacts upon old-age pension financing. The immediate result of these measures is of course a reduction in contribution revenue but it is hoped that those engaged under these schemes will be fully (re)integrated into the active population and will generate contribution revenue once the active employment measures cease.

6. Promoting global competition

As international competition continues to grow, states have shown an increasing awareness of the importance of labour costs in attracting and maintaining industry. In this context, many nations have tried to relieve the pressure on employers by reducing the contributions they have to pay to social security funds. Some states have shifted the social security burden from employers' onto employees. This was the case in Finland, Hungary, Latvia, the United Kingdom, Luxembourg and Moldova. For example, in Hungary, employer's contributions were reduced from 24% of gross earnings in 1998 to 23% in 1999, and to 22% in 2000. In the meantime, employees' contributions were increased from 6% of gross earnings in 1998 to 7% in 1999, and to 8% in 2000. The trade-off in contributions between employers and employees is not always this clear. For instance,

simply reducing the amount of employers' contribution without providing a similar reduction for employees shifts the real burden from businesses onto the individual. Employers' contributions were reduced by a considerably larger amount than employees' in the Czech Republic, Norway, Sweden and Slovakia. The reasons for shifting the relative burden of contributions from employers onto employees may, of course, be due to reasons other than globalisation. For instance in Sweden, the shift was motivated by a desire to make employee contributions more visible.

However, in some countries efforts have been made to reduce the direct effect of this shift on employees. For example, in 1996, Finland abolished its national pension premiums for employees in order to redress the balance between worker and employer contributions.

The burden has also shifted from employers to the state. This places the costs of social security on the broader base of general taxation which is levied on all income and not just that from work. This has taken place in Portugal, Norway and the United Kingdom. In other countries, state financing has been increased in order to avoid any additional pressure on employers and employees. This was the case in Germany, Greece, the Slovak Republic and Estonia. This has been achieved in a number of ways. In Estonia, certain pension funds were simply transferred to the state budget. In Greece, a new tri-partite financing agreement between the state, employers and employees was made for all labour entrants after 1993. In the Slovak Republic, the state tried to temper its increased role by offering loans to the Social Insurance Agency in order to cover any deficits in the pension fund.

Global competition is clearly a very serious issue. Every nation wants to attract investment by minimising labour costs. Many nations in central and eastern Europe are fully aware of the benefits they could derive from their considerably lower levels of wages and social contributions.

7. Promoting private pensions

By encouraging affiliation to private occupational or individual pensions, the state pension schemes will be relieved of some of the financial pressure anticipated as a result of the ageing population. In 1997, the new British Government claimed that it would change the current ratio of social security to private pension coverage (that then stood at 60:40) to 40:60 in favour of private pensions. Income tax reductions have been used to encourage people to enter private pension schemes in most of the states in the West.

Of course events such as the Maxwell scandal in the United Kingdom (where the business tycoon Robert Maxwell failed to separate the pension funds of his employees from other company assets, and allegedly his own assets) and the disastrous collapse of pyramid financing schemes in certain parts of central and eastern Europe have made improved protection of supplementary pension schemes a necessary corollary of any efforts to encourage participation in these schemes. New regulations were therefore imposed over the reference period in order to protect better the rights of participants in supplementary pension schemes, especially those in occupational schemes. Measures to this effect were adopted in Albania, Luxembourg, Switzerland and the United Kingdom. These regulations typically dealt with the separation of pension funds from the general assets of the firm they work for as well as the management of each individual's acquired rights when that person changes occupation or their employer becomes insolvent.

8. Improving efficient administration

The pressure on pension financing can be relieved by cutting costs within the administrative systems. One means of ensuring this is improved training of staff, which has taken place through intensive schemes in Albania, Turkey, Greece, Canada, Romania and the United Kingdom. Another popular means of reducing staff numbers and working hours spent on administration is the creation of a single contact point where insured persons can go in order to obtain information on and assistance with all branches of social security. This policy has been developed in the United Kingdom where the one-stop shop principle dictates that an insured person can deal with all enquiries and applications concerning any branch of social security in one office. Similar schemes are in operation in Ireland and Australia.

Administrative costs have also been reduced by more extensive contracting-out of certain services. Albania, Australia and the United Kingdom have all tendered basic administrative tasks to private or semi-public bodies in the belief that competitive forces will lead to a reduction in costs. In 1998 for example, the Australian system separated its service delivery part and contracted the provision of these services to "Centrelink", which now calculates and pays social security benefits. In Albania an agreement has been signed between the Savings Bank and the Institute of Social Security in which the responsibility for paying benefits in the cities has been transferred to the Savings Bank.

Reference has already been made to Article 77, paragraphs 1 and 2 of the revised code which states that, with the exception of non-compulsory

supplementary schemes, representatives of those covered by the system should be involved in its administration. How far should this requirement affect contracting-out of "basic" administrative functions?

9. Increased personal scope

In spite of the fact that pension financing mechanisms are under increasing pressure, all European states are still concerned with ensuring full coverage of their populations for the risks in old-age. The obligation to attain such coverage may stem from international norms such as those developed by the Council of Europe or the International Labour Organisation but it is more likely to have originated from the national political pressure that often found support in express commitments contained within national constitutions. The personal scope of compulsory insurance was extended in several states during the 1990s including Austria (those under "free contracts" earning above a set limit), Italy (shopkeepers), Greece (certain farm workers) and Germany (students earning above a certain amount).

Other states have decided to increase the scope of voluntary insurance. These include Portugal (certain groups of self-employed persons), Italy (non-working women) and Latvia (all those aged over 15 years who are not already covered by a compulsory scheme).

Challenges for health-care financing in the 1990s

Both states in eastern and western Europe have faced the same challenges to their health-care financing systems during the 1990s. These challenges placed pressure upon all types of health-care provision, regardless of whether the benefits were provided by national health services or health insurance funds.

The last decade of the twentieth century was one of escalating health-care costs. The demands on health-care budgets can be attributed to the ageing of the population and the rapid development in technology that makes equipping hospitals and health centres much more expensive. Many states took a closer look at their administrative systems and discovered unacceptable levels of inefficiency and waste, inefficiency and waste which only exasperated increasing costs.

The increasing costs of health-care placed states in a difficult dilemma. On the one hand they had to reduce expenditure but on the other they had to honour their duty to provide their whole population with access to quality social health-care. This duty can be found in the international law of organisation such as the Council of Europe as well as national constitutions.

Trends in health-care financing in the 1990s

This section isolates eight essential trends in the organisation of health-care financing in the member states of the Council of Europe between 1990 and 1999. These trends are based on the motivation behind the development of social security law during this reference period.

1. Encouraging the responsible use of resources

Many states have tried to encourage the more responsible use of resources by all those involved in the social health-care system. This includes administrators, social insurers and service providers who have frequently been identified as inefficient and wasteful. It also includes patients who operate in what has been perceived as a market where demand is determined by supply and many people believe that you simply cannot have "enough health".[8]

One means of increasing the responsible use of resources by providers and administrators of health-care is to impose greater monitoring. For example, quality indicators were introduced in Italy in order to constantly assess the standard of services and supervise spending. A similar method has been introduced in Poland where a "Medical Care Register" was established and a new system for the registration of local health-care centres introduced. In Belgium the prescription behaviour of family doctors was carefully supervised.

In the Netherlands the financing system was amended in order to encourage increased responsibility by administrators. It was decided that the state would no longer cover the full deficits of the health-care system, thereby allowing an obvious deficit to develop. It was hoped that by slipping into the red, administrators and to some extent the public would develop a better appreciation of the costs of health-care.

An extensive public information campaign was established in Canada in order to make people think before they used valuable health resources.

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8. See Nickless, J., *The consequences of European competition law for social health-care providers (1998)* MAKLU/Antwerp.

2. Increasing the participation of patients in the costs of health-care

The increase in costs to patients is very much linked to the trend described above in that many states hoped that introducing or increasing charges for medical treatment would make patients think twice about using medical resources. It was of course also a very good way of increasing revenue and relieving some of the pressure on the health-care budgets. Patients were obliged to contribute to health-care costs in a number of different ways. Most states rely upon general contributions to finance health-care costs but this income can be enhanced by a number of methods. For example, a co-payment could be charged for each visit to a doctor or treatment received in hospital. Alternatively reimbursement mechanisms, whereby the patient pays the doctor the full fee directly and is then reimbursed a percentage of this fee by a health insurer, could decrease the percentage that is repaid to the patient. Finally, a system may demand a franchise, which is a standard annual payment, and then charge the patient a percentage of any costs they incur above this amount. Co-payments are not applied to everyone, and usually exempt persons on low income, suffers of specified diseases, or children. Some states limit co-payments by introducing an annual ceiling, which represents the maximum amount anyone can pay in one year.

Co-payments were introduced for the first time in many central and eastern European countries including Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland and Romania.

Some states extended existing systems of co-payments to cover new treatments and services. This was the case in Austria (rehabilitation treatments) and Norway (specialist psychologists).

Many countries increased the level of co-payments, either by increasing direct charges, increasing annual ceilings or reducing the percentage of costs returned in reimbursement mechanisms. These countries included Austria, Belgium, Finland, Germany, Italy, Norway, Sweden and Switzerland.

Both Italy and Greece amended their system of co-payments. For example, in the early 1990s, most Greek citizens were obliged to purchase an access card before they were entitled to hospital treatment.

Some states decided to increase the general contribution for health-care. These included Austria, Luxembourg and Germany.

However, there is now a growing trend to decrease the level of co-payments. This trend began at the end of the 1990s. For example, Latvia reduced its

newly introduced co-payment of 25% of the costs of treatment to 20% in 1997. In 1998 co-payments for children were abolished in Sweden and Austria was able to reduce co-payments as a result of a surplus in its health-care budget. Co-payments were also reduced in Germany and Belgium around this time. Finally, in 1999 the Dutch Government decided to abolish its 20% co-payment for all treatments after research indicated that this payment did not reduce consumption and only led to increased administrative costs.

3. Gaining tighter control over health-care budgets

All states have made efforts to increase control over their health-care budget. In many central and eastern European countries this was done by reducing the numbers of hospital beds, this was particularly obvious in Latvia, Lithuania and Estonia.

Other methods included restricting funding for specific services which was proposed in Germany at the end of the 1990s. This German measure was vigorously opposed, as it was feared that it would disadvantage generalist doctors in areas heavily populated by elderly people who necessarily require higher budgets.

Cost control mechanisms such as restrictive budgets and the deliberate development of waiting lists through restrictions on the number of hospital beds may have a potentially enormous impact on the quality of a social health-care system. These mechanisms have to be carefully planned in order to protect levels of care, especially for certain high-risk groups such as the elderly, new and expecting mothers and children. They must also be assessed to prevent regional inequalities particularly in rural areas and places characterised by high levels of retirees.

4. Introducing market mechanisms

Many countries were of the opinion that increased market type mechanisms would force greater efficiency in the allocation and utilisation of resources. The introduction of competition type factors in social health-care took place in a number of ways.

It was hoped that allowing patients increased choice of provider might encourage providers to improve their treatment and increase efficiency. In

the early 1990s, Danish patients were given the option of attending any hospital in the country in order to obtain certain treatments. In 1997 the range of treatment for which this choice was available was increased and hospitals became obliged to inform patients about their rights to travel. The choice of obtaining hospital treatment right across the country was also provided in practice to patients in France. Finally, the option to choose and change family doctors, within each patient's region, was offered to those in Poland, Spain and Sweden.

Social health-care systems in most European Union states will sign contracts with private hospitals and other providers for social health-care services. Contracting out in this way forces providers to provide quality services at low prices. Contracting out has been introduced for the first time in many central and eastern European countries including Bulgaria, Croatia, the Czech Republic, Latvia, Hungary, Slovakia, Slovenia and Romania.

Contracting out has also been considerably developed in the Netherlands, Turkey and the United Kingdom. The conservative government of the United Kingdom developed an extensive system of tendering and contracting in the early 1990s by introducing such innovations as GP fundholders. GP fundholders were essentially family doctors given the power to contract with hospitals for the specialised services required by their patients. The internal market for health-care established by the conservatives has been reversed to some extent, although not a great deal, by the new labour government that entered into power in 1997.

Increased competition between social health insurers has been introduced in Belgium, Germany and the Netherlands. For example, in Germany, people were given the right to change their insurer should the premiums increase or the insurer decide to change its statutes.

5. Setting standards

Setting standards for the quality of providers and level of services will increase the costs of social health-care but on the other hand it is an important part of ensuring quality treatment to the population. Standards for the accreditation of doctors and medical institutions have been introduced in most central and eastern European countries. Increased standards also became the focus of the Patients' Charter in the United Kingdom in 1993. This charter prescribed such things as minimum waiting periods for operations or treatment in Accident and Emergency Units. In 1996, France also introduced a system of accrediting hospitals and assessing doctors.

6. Altering the scope of benefits

The health-care systems could clearly save money by reducing the scope of treatment covered by social provisions. Both France and Spain introduced a clearer definition of the range of treatment provided. In both cases this involved the application of tests relating to effectiveness and usefulness. In Spain, this resulted in the exclusion of a number of treatments such as aesthetic and cosmetic surgery.

Certain treatments were excluded from the social sphere in Belgium (spa treatment) and Germany (dental care for those born before 1997). However, the range of treatment was increased in Turkey (prosthetics for the those covered by the scheme for self-employed persons) and Belgium (tube feeding).

Expenditure on medicines accounts for a substantial part of health-care budgets and reducing the costs of pharmaceuticals can potentially save a lot of money. In Greece and Spain, new lists of drugs covered by the social security system were released in an attempt to better regulate the costs of pharmaceuticals. In Sweden, the range of drugs available under the social health-care system was also curtailed by removing some "prescription only" medicines from the system. The promotion of cheaper generic drugs has been used to cut costs in France, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

7. Increasing personal scope

Although increasing the personal scope of health-care increases the financial pressure on the health-care budget, it is an important part of every state's continuing obligations to its people. For example, in the Netherlands, recipients of the general old-age pension who had an income below a set threshold became entitled to free coverage under the Health Insurance Act. In Finland, free treatment was extended to those with communicable diseases whilst in Spain the system was opened to all immigrants, legal and illegal.

8. Promoting private care

Increasing the number of people covered by private insurance means that fewer resources will be used by social health-care systems. In Australia, middle-income families were given a subsidy towards private health-care

of up to A$450, whereas high-income earners faced tax penalties if they did not take out private insurance. Various states in Europe also promoted private health-care but the trend in some of these has been to remove any incentives to "go private". For example, in Germany, people on higher income used to be allowed to opt out of certain services as it was assumed that they would have private insurance. This process has now been abolished, as many people perceive it to be in violation of the principle of solidarity. In Spain, the tax incentives given to individuals to take out private insurance have been removed although employers are still given tax rebates if they organise private health-care for their employees.

Some consideration should be given to the inter-relationship between private and social health. It is particularly important to address the continuing obligations to the social system of those who undertake private medical insurance.

Conclusion

Despite the great divergence in the organisation and administration of old-age pension schemes and social health-care schemes across the Council of Europe, the social protection systems in every one of its member states had to face a series of similar challenges. These were principally concerned with the pressures of an ageing population. For old-age pensions this placed a serious burden on traditional PAYG financing mechanisms and for health-care this resulted in increased demand for increasingly expensive medical treatment. As all these countries faced similar challenges they also developed similar solutions, allowing the isolation of various trends and developments in social security policy in both the old-age pension and the health-care fields. These "common concepts" of the 1990s are described below.

Improved efficiency: Developing more efficient methods of administration was seen as a means by which to avoid waste and reduce costs. In the pension field this resulted in the development of databases and intra-governmental co-operation in order to improve contribution collection and reduce fraud. In the health-care area, governments aimed to improve administration by greater standard setting and monitoring.

Competition, choice and the private market: The increased role of market forces is closely linked with the concept of improved efficiency. Increased competition was obvious in the health-care sector where many states contracted out social services to private providers and competition was encouraged between social health-care insurers. Some states considerably increased the patient's choice of hospitals or doctors in the hope that this would encourage more efficient allocation of resources and improve the quality of service. In the old-age pension field, states attempted to place greater reliance on private and supplementary insurance, which they actively encouraged through tax exemptions. The administration of "first pillar" statutory compulsory pension schemes in several member states was contracted out in order to improve service and reduce costs.

Quality of service: During the 1990s, the recipients of social security evolved from "claimants" into "clients". Extensive efforts to improve the quality of both health and pension services were made during this decade. Single contact points were set up to enable people to organise all their social security needs from one office, the training of staff became a focal point and new standards were publicised to tell clients exactly what they could expect from the system.

Increased responsibility : A great deal of effort was also made to increase the awareness of the public as regards their responsibility to the social protection system. In old-age pension schemes, this involved encouraging people to defer claiming their pension by working beyond the normal pensionable age. Attempts were also made to deter people from claiming early pensions. Patients were encouraged to be more careful in their use of health-care ; this involved the introduction and development of co-payments or other forms of patient participation. Although there was a discernible trend in some member states to reduce patient participation during the final years of the 1990s. Doctors, institutions and administrators were also encouraged to use resources more responsibly, this was often achieved by increased monitoring and supervision.

Sustainability : This concept describes a situation where systems function not just in the short-term but the long-term as well. Issues of sustainability were of particular importance in the old-age pension schemes, where fears about the long-term future of PAYG systems led to the development of funded schemes whereby people save for their own pensions rather than simply financing the pensions of the inactive population. Funded elements were introduced into the statutory compulsory pension schemes in several central and eastern European states and also started to feature in schemes in the West. Fears for the sustainability of the statutory old-age pension schemes also led to the creation of pension fund reserves and greater reliance on alternative financing mechanisms. The sustainability of health-care financing focused on the urgent need to gain tighter control of escalating health-care budgets. This was achieved by cost containment mechanisms such as reducing the number of beds or restricting funding for specific types of treatments or institutions.

Harmonisation : Reducing the difference between various schemes for different regions or different professions occurred within both pension and health-care schemes. However, the motivations for harmonisation differed between these two areas. The aim of enhanced harmonisation in health-care was to ensure greater equality of treatment and a more efficient service. One of the aims of increased harmonisation in the pension field was to remove some of the costly privileges given to special groups such as civil servants or airline pilots.

Increased personal scope : The goal of universal coverage for the risks of old-age and health-care stems from international and, more pressingly, national political pressure. Efforts were made in both the fields of pensions

and health-care to expand the availability of social protection to groups of people who were previously excluded. This led to the increased scope of both compulsory and voluntary social insurance.

Increasing revenue and decreasing expenditure: States reduced their expenditure by reducing benefits, sometimes this involved blatant reductions in the amount or range of benefits whereas in others it involved subtle changes to the calculation method or formula. Indexation was also a popular tool to reduce the real value of benefits. Steps were also taken to improve revenue, through the introduction or increase of patient co-payments or the enthusiastic battle against fraud.

The observation of trends and developments in the field of old-age pensions and health-care enables one to isolate several areas where greater direction from international standards may be beneficial. For example, indexation should be controlled so that it is fair, transparent and reflective of the economic situation rather than the political one. Greater control is arguably necessary to prevent increased global competition leading to greater pressure being placed upon employees and tax payers as states try to lower hidden labour costs. A growing reliance on alternative financing through increased consumer taxes such as VAT threatens to create hardship to persons of small means. The combat of fraud has been placed high on the political agenda of many states, leading to the creation of new or stronger fraud investigation units. Although these investigation units will be subject to the rules contained in the European Convention of Human Rights, it may be desirable for further international guidance concerning their powers of search and detention. Social security is a dynamic concept and some directions would be welcomed regarding the organisation and publicity of transitional measures, such as those involved in raising the pensionable age. Finally, the various methods engaged in order to contain health-care costs should be subject to international rules to ensure that they do not have a detrimental impact on vulnerable groups such as the elderly or those residing in rural areas.

The common concepts listed above had an appreciable impact on social protection financing and philosophy during the 1990s. They came from common solutions directed at common problems and there is little doubt that they have also gone a long way in shaping the social security systems of the new millennium.

Appendix

Future developments in old-age pension and health-care financing : issues of social cohesion and solidarity

Introduction

Whereas the paper above focused upon trends and developments that had occurred in the past, this annex makes some predictions about old-age pension and health-care financing in the future. In many respects it acts as a warning by isolating certain trends and developments which, if left unchecked, may have an adverse impact upon the principles of social cohesion and solidarity that lie behind the European model of social welfare. The essence of social cohesion is the creation and maintenance of equality within our societies by overcoming discrimination and unfairness based upon a person's sex, race, religion, ethnic background or income. The concept of solidarity relates to those who have, sacrificing so as to protect and support, those who have not.

This annex is divided into two main parts : the first deals with prospective developments in old-age pension financing and the second focuses on the future of social health-care financing.

Old-age pensions

The introduction of funded elements and the movement towards individualisation of pension financing.

The challenge of an ageing population has already encouraged several states to introduce a funded element to their old-age pension financing systems. These funded elements replace, to a greater or lesser extent, the PAYG system previously used to finance old-age pensions. PAYG systems operate through the collective approach, whereby the economically active population pays the benefits for the inactive one. These systems provide defined benefits that may or may not be related to previous earnings but in any case can be predicted with a reasonable degree of accuracy. Funded systems use an individual approach whereby each worker saves for his or her own future by making regular payments into a central fund. The central fund is then invested. When workers in a funded system reach pensionable age their benefit is calculated according to how much has been saved in their individual account plus any returns on the investment of that money. This amount is then commuted into a periodic payment either through actuarial calculations based on life expectancy or by the purchase

of an annuity. Thus, benefits depend upon the return on investments and the general state of the economy, and it is difficult to predict, even towards the end of someone's working life, how much will be in the individual's account and therefore how much benefit that individual may expect to receive.

The introduction of funded elements to pension financing mechanisms in central and eastern Europe is being strongly encouraged by the World Bank. Recently, Sweden introduced a small funded element to its pension system and is currently being observed with interest by other countries in western Europe. The movement towards funded systems that has been noted during the 1990s is therefore likely to continue in the future. This raises several important issues as regards social cohesion and solidarity.

Firstly, funded systems develop a stronger link between contributions and benefits : the more one pays in during one's working life the more one will receive after reaching pensionable age. This could cause a problem for the following groups of people :

– those on lower incomes who will inevitably contribute less to their individual pension savings fund, resulting in a lower pension even though they may have worked and contributed over many years ;

– those who have spent a lot of time performing unrecognised work in the informal sector, the informal sector representing a significant problem in parts of central and eastern Europe ;

– those who have interrupted their career in order to raise children or care for sick relatives, this group being mainly composed of women.

Secondly, the individual financing approach adopted in funded systems increases the degree of risk. Poor economic performance could have a devastating impact on benefits. Furthermore, even as workers near the end of their career the risk element (and possibly other factors such as the annuities market) make it very difficult to accurately predict the amount of benefit that can be expected. Investment risk is not the only burden faced by workers in a funded system, there is also the risk of mismanagement and even embezzlement. Massive investment funds will be at the mercy of those charged with their management whilst simultaneously representing a great temptation to fraud. Any major problem with the investment funds risks the social welfare and equality of pensioners.

A word should also be said about efforts in certain states to improve the link between contributions and benefits by establishing a system whereby

workers are allocated their own individual accounts which record their contributions throughout their working lives. Their old-age benefits are then calculated on the basis of the final balance in their account. However, the contributions, instead of being invested, are used to finance the needs of existing pensioners. In other words, the system operates on a collective PAYG basis and a record is kept of each individual's contributions. This system aims to encourage people to move away from the informal sector and pay contributions on their full income. It avoids some of the financial risks associated with funded systems but careful consideration still has to be given to protecting vulnerable groups such as those on lower incomes and those who interrupt their careers in order to care for children or sick relatives.

The potential problems of funded systems can be overcome. Relying on a three-tier system whereby an element of PAYG financing is retained will allow states to provide a basic benefit to those on low incomes or those who, due to time spent in the informal sector, have not accrued many contributions in their funded element. The state could ensure equality for those who interrupt their career to care for children by paying credits into their individual account. Careful regulation regarding how the central fund is invested could cushion the impact of poor economic performance. Strict regulation and regular auditing will deter embezzlement and, should funds nonetheless become the subject of fraud, identify the problem quickly and allow its rectification.

The funded system is promoted by international bodies that are interested in economic growth and the development of enhanced competition. International organisations such as the Council of Europe and the International Labour Organisation (ILO) are making efforts to encourage states to balance economic interests with social ones. The European Code of Social Security and ILO Convention No. C102 both demand that social security should be funded collectively and based on the principle of solidarity. Funded systems, whereby individuals save for their own needs, do not comply with these requirements. The Council of Europe has undertaken extensive assistance programmes in central and eastern Europe in order to encourage the ratification of the European Code of Social Security. These programmes highlight the dangers of funded systems and explain that these systems do not comply with the Europe Code. The Council of Europe is making efforts to explain to all states in transition that funded systems are not the only way to protect pension financing from the threat of our rapidly ageing populations. Movement towards individualisation is by no means the only step forward and collective systems that involve less risk, and that are founded on principles of solidarity, are still an option.

Concerted efforts could be made to develop an internationally approved model that may be advanced as an alternative to the carefully designed package promoted by the World Bank. An example is a three-tier system, starting with a first tier providing a basic minimum benefit supported by a second tier based upon years of employment and a final tier providing an earnings-related benefit. All three tiers could conceivably be financed on a PAYG basis. The second tier rewards those who have worked for a full career even though they may not have had particularly high earnings. This results in income redistribution between the rich and the poor and encourages people to remain economically active, delaying the payment of their pension whilst simultaneously ensuring continued revenue. Private individual investment could then be encouraged by the state through tax incentives and the like.

In conclusion, the challenge of an ageing population has brought European pension financing to a metaphoric crossroad. The countries of Europe must decide which way to go. Should they proceed straight ahead and continue to finance their systems as they always have done, making small amendments and repairs on the way ? This will involve maintaining existing systems of collective financing and continued compliance with the European Code of Social Security and ILO Convention No. C102. However, it may lead to increased contributions from workers and employers that may in turn effect national competitiveness and push workers into the informal sector. Alternatively, they could take the road towards greater individualisation and step into a funded system. This path is encouraged by international organisations concerned with economic growth, privatisation and enhanced competition. The other option is a full reform of the pension system in order to strengthen solidarity and collective financing. This path would no doubt find support from the Council of Europe and the ILO.

In reality some states have already taken the funded direction and others have strayed off the road in order to develop their own hybrid systems. Funded systems will continue to play a role in pension financing in the decades to come. These systems may well offer some protection against the impact of an ageing population but some degree of international social guidance will be required in the establishment and running of these systems. The European Code of Social Security and the ILO Convention No. C102 were developed before funded pension systems became a real issue. These international instruments condemn funded financing and therefore provide no guidance on how states that do adopt these systems may protect the social rights of their people. Funded systems are already

in operation in western, central and eastern Europe and new systems will inevitably appear in the future. Some form of international guidance is therefore needed in this area as regards :

– minimum guarantees for low-income earners, those who have spent a long time working in the informal sector and those who have interrupted their careers to care for another person ;

– how the funds should be invested, for example the balance between equities, government bonds and property as well as the distribution between foreign and domestic investment ;

– how and when the funds should be audited and supervised ;

– who should administer the funds and what role should be played by representatives of the contributors in investment decisions.

Alternative financing

A number of states have introduced new methods of financing designed to ease the pressure placed on the traditional sources of revenue, which are social security contributions and taxation. New taxes have been levied on such things as the profits from pharmaceutical sales, car insurance premiums and company cars. Set amounts of the revenue from taxes on tabacco and alcohol have also been earmarked for social security financing. Furthermore, consumer taxes such as VAT have been used to finance social security funds. By targeting specific goods and services alternative financing could have an important effect on income redistribution. By targeting luxury goods such as company cars or the profits of specified industries a state may ensure a redistribution in favour of the low paid. However, targeting pseudo-necessities such as alcohol and tabacco will have a greater negative impact on lower-income families. Careful thought has to be given as to what products attract earmarked taxes. Although the consumption of cigarettes and alcohol should be discouraged for social and health reasons, one should not forget that they still play an important role in many family budgets. Both products are habit-forming and therefore as the price increases cash will be transferred from other items within the usual pattern of family expenditure. The effect of this transfer will not be so dramatic for those on higher incomes but may have a severe impact on low-income families.

Any increases in VAT are also going to affect low-income earners far more than high-income recipients. VAT is universally recognised as a regressive tax. If it is to be used to finance social security it should be adapted in

such a way as to reduce any negative effects on low-income families. For example, the range of products exempted from VAT should reflect the real necessities of low-income families (for example, children's clothes, infant food, etc.). Consumer taxes are already subject to some international influence from the European Community, where the aim is to ensure that they do not adversely interfere with the free movement of goods and services. As soon as VAT is used as a source of alternative financing for social security purposes other international bodies may become involved in order to promote social cohesion and the pursuit of other altruistic goals as opposed to the current focus on the liberalisation of trade.

Health-care

Co-payments : is this really the end of an era ?

Although some countries have reduced or entirely abandoned their systems of co-payment there is no guarantee that the rest of Europe can or will follow their example. The levels of co-payments are currently monitored by both the European Code of Social Security and the protocol to that code. The guidance given by the code is somewhat vague, requiring co-payments to be arranged so as to "avoid hardship". The protocol, on the other hand, prescribes maximum rates for co-payments based on the percentage of the actual costs of the goods or services concerned. No provisions exist to determine who should be exempt from co-payments. Some form of international guidance is required to ensure that low-income earners are not discouraged from consulting doctors and other medical practitioners. In the long run such delays in seeking medical advice will not be productive and will probably end up costing the health-care system more in order to treat ailments in their later stages of progression. Exemptions to co-payments could be based on income whereby those earning below a specified amount are totally or partially exempt from co-payments. Ceilings may also be developed establishing a maximum annual amount that a person may spend on co-payments : any co-payments exceeding this amount are then covered by the social security system rather than the individual. The ceilings used could vary according to the family income of each individual concerned. In some states the victims of specified diseases, such as cancer, Aids or tuberculosis are entirely exempt from co-payments for the treatment of their illness.

The international guidance on co-payments could take a number of forms, for instance, the conducting of extensive research and the dissemination

of information. Studies could be conducted into the effect of co-payments on patient attendance at medical centres, looking into some of the following questions :

– Do co-payments discourage people from consulting a doctor and which groups do they discourage ?

– Do co-payments really encourage the more rational use of resources by patients ?

– Who pays the most in co-payments as a proportion of their total income ?

– How much does any delay inspired by co-payments actually cost the social health-care system in the long run ?

The results of such studies would have a strong political influence in the states in which they are conducted and would enable the dissemination of information regarding best practices to states that have not been subject to such close scrutiny.

The geographic expansion of the European Union

It is safe to say that in the next ten years the European Union will have expanded to some degree into central and eastern Europe. The introduction of the internal market into central and eastern parts of Europe, with its free movement of workers, self-employed persons, goods and services will place considerable pressure on the financing of social health-care in the new member states. EU laws provide for the mutual recognition of medical and other diplomas allowing doctors, specialist consultants, nurses and other members of the medical profession to move freely from one EU state to another. Medical professionals in the current member states of the EU earn considerably more than those in the prospective states. There are well-founded fears that doctors, surgeons, nurses and other specialists will be tempted out of central and eastern Europe and into western Europe. This prospect is not entirely unrealistic given that most movement within the European Union involves well-educated people who are not inhibited by linguistic constraints. Given that most medical textbooks and journals are printed in English, German and French, medical students in central and eastern Europe will typically be able to speak at least one other European language.

The wide-scale migration of specialist medical staff from central and eastern Europe could have a serious impact on the quality of medical services

available and the costs of those services. In order to maintain a functioning social health-care system the central and eastern European states will have to provide competitive levels of pay compared with the rates paid in the social and private medical sectors in western Europe.

Protecting the social health-care systems of those central and eastern European states entering the European Union will require a careful balance between the economic principles of the free market on the one hand and the principles of enhanced social cohesion on the other. The wrong balance could result in reducing social cohesion on a European level, promoting inequality between entire nations. Careful research and consideration are required and, although the European Union is not a member of the Council of Europe, some degree of inter-institutional co-operation may be necessary on this matter in order to ensure that the social goals of both bodies are not placed in jeopardy.

The increasing role of private insurance

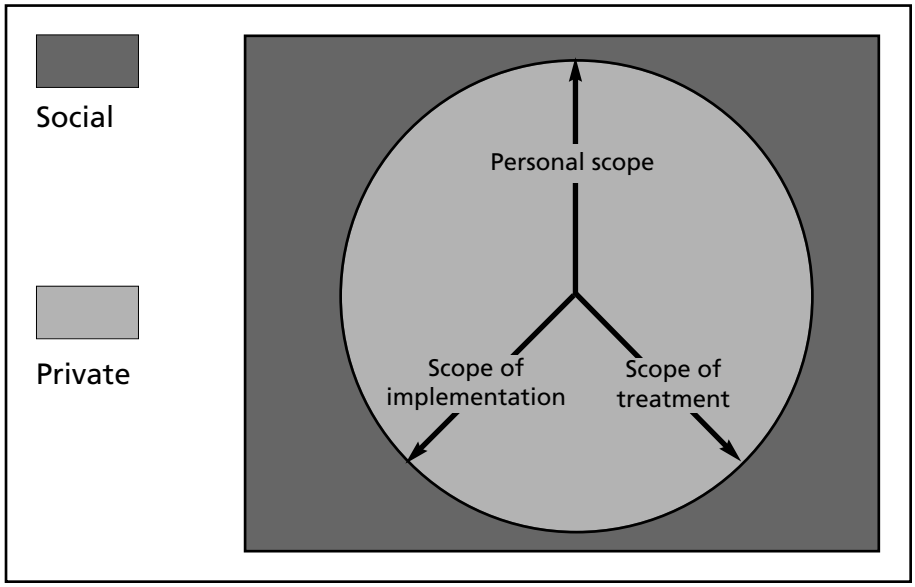
The concept and scope of private health-care is negatively defined : it is all health-care treatment that is not covered by the social system. In other words it is all health-care treatment that is not funded wholly or partially by social security. The scope or boundaries of social health are determined by three basic elements :

– personal scope : this refers to the range of people covered by the social system, some states having excluded high-income earners from the personal scope of health-care because they can afford private insurance ;

– scope of treatment : this dictates the range of goods and services available under the social system, for example many countries exclude purely cosmetic surgery or dental care from their social systems ;

– scope of implementation : this indicates the range of health-care providers and institutions which are entitled to provide medical goods and services to social health-care patients. Some states will only allow social patients to attend doctors or hospitals that are employed or owned directly by the state, while others allow patients to attend self-employed doctors or private hospitals contracted by the social system. In countries that operate reimbursement mechanisms, such as Luxembourg and Belgium, social patients are free to attend any doctor lawfully practising in the country.

This model can be visualised as follows:



The light grey circle represents social health-care coverage whereas the outer dark grey region represents private coverage. Thus, whenever a patient steps over the border by asking for a treatment that is not covered by the social system or going to a doctor who is not contracted by the social system, he or she becomes a private patient and is obliged to cover the full costs of his or her treatment. This patient may cover the costs of private treatment either from their own savings or through private insurance.

Low-income earners, who have no savings and cannot afford private insurance, are restricted to the inner grey circle. Some states are reducing the three elements that determine the size of this circle. They are reducing the range of treatments provided or essential drugs available under the social system. They are also reducing the scope of implementation by restricting the number of available hospital beds or contracts available for medical consultants. As the light grey circle retracts the pressure placed upon lower-income earners increases. The boundaries of social health-care have to be carefully managed. Expensive private medical treatment can have a devastating impact on a family's financial situation and efforts must be made to ensure that the social health-care systems continue to do their job: provide people with real security.

Some member states of the Council of Europe have been encouraging private health-care and private health insurance, which raises two issues of particular interest in relation to social cohesion.

Firstly, there is the question of whether private health insurance should supplement or substitute social coverage. Supplementary private insurance means that the insured person continues to make contributions to the social health-care system. Taking private insurance as a substitute to the social system means that the insured person leaves the personal scope of the social system and therefore makes no further financial contribution to that system. The danger of allowing substitute private insurance is that high-income earners will leave the social system and will stop paying contributions. The impact of this will be far greater on those systems within which the social system of health-care is financed by contributions based on earnings. Furthermore, allowing high-income earners to leave the social system will have a negative actuarial effect as those on higher incomes are less susceptible to certain types of illness.

Secondly, health-care providers operating in the private sector tend to receive higher earnings than those performing the same tasks in the social system. Many social health-care providers are thus tempted to move into the private sector. This in turn places financial pressure on the social system which is forced to compete by paying higher wages or face the problems of a shortage of staff. Higher wages in the private sector have been identified as one of the factors that has led to a dearth of nurses in the United Kingdom's National Health Service (NHS). The state has responded by moderate increases in pay and extensive advertising campaigns aimed to encourage those who have left the nursing profession altogether to reintegrate into the NHS. The so-called brain drain from the social to the private sector threatens to reduce the quality and availability of social health-care treatment.

The member states of the Council of Europe have to give serious consideration to the inter-relationship between private and social health-care. There is a danger that financial pressure will force states to reduce the personal scope of treatment and implementation. This can be done without violating the provisions of the European Code of Social Security or the protocol thereto. The revised code provides a little more protection but there is still the danger that states will embark upon a race-to-the-bottom in order to relieve the pressures of financing. Tightening the boundaries of social health-care will result in the exclusion of those who cannot afford private care. The impact of reduced social care may be cushioned for the

very poor by applying means tests for certain medical goods and services. If means testing were introduced to the social system it would have to be very carefully balanced to ensure that those who fail the test can still afford private care, otherwise there is a danger of excluding middle-income earners.

The financial pressure placed upon social health-care systems in Europe means that something has to be done to increase (or at least maintain) revenue whilst simultaneously controlling rising levels of expenditure. A variety of cost-containment measures are in operation throughout Europe. These include strict budgeting, reducing the number of available beds and maintaining long waiting lists for non-essential operations. The European Code of Social Security does not provide any guidance on cost-containment and some advice (or even supervision) on an international level may prove beneficial. For example, the publication of best practice might be helpful, or perhaps the development of a list of internationally approved or recommended cost-containment methods.

Conclusion

This appendix has attempted to isolate some of the dangers that may threaten social cohesion and solidarity in the future. On a number of occasions it has referred to the need for international guidance. It should be borne in mind that international guidance may assume many forms. It may involve the imposition of supervised minimum standards such as those to be found in the European Code of Social Security or the ILO Convention No. C102. It may also involve the organisation of research and the dissemination of the results thereof. It could further include adopting expressions of policy or even providing approval for certain types of activity, such as approved models for pension financing or cost-containment measures in the health-care sector. International guidance should be aimed at generating debate at a national level among both politicians and the public.

Globalisation and calls for economic liberalisation at both national and international levels, combined with the financial pressures exerted upon social security financing do pose real threats to social cohesion. However, greater economic freedom and measures to contain the costs of social security may improve standards of living. The important thing is to achieve the right balance and this needs a strong international voice speaking out for the promotion of social cohesion and the maintenance of social solidarity. In the past this voice has emanated from institutions such as the Council of Europe and the ILO. The co-ordinated efforts that are taking place in

the meetings of the Committee of Experts on Standard-Setting Instruments in the Field of Social Security and the European Committee for Social Cohesion, as well as the extensive assistance programmes in operation in central and eastern Europe and international debates such as the 89th Session of the International Labour Conference, will ensure that this international voice will continue to be heard throughout the decades to come.

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