

# Estonia's statutory funded pension scheme on the way to being made voluntary

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*In January 2020, the pension reform bill was voted through by the Parliament. The Pension Reform Act will make membership of the statutory funded pension scheme voluntary, i.e. it will be possible to opt out and withdraw one's money or suspend drawing of one's pension. However, the President sent the pension reform bill to the Supreme Court, arguing that there are unconstitutional aspects.*



## Description

The Estonian pension system consists of three schemes: i) a state pension insurance (the "first pillar", a pay-as-you-go system); ii) a statutory funded pension scheme (the "second pillar"); and iii) a voluntary funded personal pension scheme (the "third pillar") (read more: Piirits and Laurimäe 2019). At the beginning of 2020, 745,998 persons were members of the statutory funded pension scheme (Pensionikeskus), i.e. about 95% of people aged 19-63.

The main problems with the Estonian statutory funded pension scheme are its low real investment rate of return, its high management fees and the rigidity of the pay-out system (read more: Piirits and Laurimäe 2019). The government coalition agreement (the government was appointed in April 2019) includes proposed changes to the pension system. In December 2019, the pension reform bill passed the first reading. Government sent the bill to the second reading with a government vote of confidence, to overcome the fact that the opposition had submitted around 1,000 amendments to the bill.

On 29 January 2020, the pension reform bill passed the parliament vote, by 56 votes in favour and 45 against. The Compulsory Funded Pension Reform Act will make membership of the statutory funded pension scheme voluntary as of 2021. According to the Act, there are several options. First, a person can continue collecting their pension, as before, and joining the second pillar scheme remains automatic for young

people also. Secondly, a person can opt out of the pension fund and withdraw all their money, or suspend new payments and leave the collected money in the fund. Thirdly, a person can transfer payments and shift their contributions from the pension fund to a personal pension investment account. (ERR 2020, Riigikogu 2020)

When a person opts out from the second pillar or stops contributions, they can re-join and start drawing a pension again after ten years. If a person opts out twice, they cannot re-join and contribute to the second pillar again. The pay-outs will be made three times a year (January, May, September) and the beneficiary will have to pay income tax on the pay-out (20%). However, the application should be made five months before the pay-out time. A person can also stop drawing their pension or begin to draw it three times a year. According to the bill, from January 2021, applications can be made to join (for people born before 1983 who have not yet joined) or leave the statutory funded pension scheme and withdraw the money (ERR 2020, Riigikogu 2020).

The pay-out phase is also made more flexible. A person can decide whether to withdraw the money as a lifetime or a fixed-term pension or as a single amount. The retiree does not have to pay income tax if they choose a lifetime pension, but must pay 10% with the new law if they choose other options. Therefore, there is an incentive to withdraw money at retirement age in order to pay less income tax. This change also applies to current retirees, because they can now terminate their annuity contract which they could not do before.

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Policymakers, social partners and experts agree that the statutory funded scheme's performance should be improved, but they have diverging views on this pension reform. Those in favour of the reform (e.g. the coalition partners, the Estonian Association of Pensioners' Societies) find that it is up to people to decide where to invest (e.g. real estate, funds) and, in their view, people should not be forced to save money in funds with a low real investment rate of return and high management fees. They see volunteerism as a solution to all second pillar problems. Those against the reform (e.g. the opposition parties, International Monetary Fund, Bank of Estonia, Estonian Chamber of Commerce and Industry, Estonian Employers' Confederation and a number of experts) think the current system should be improved rather than made more complicated – with more choice and probably higher costs of own investment and greater differences between pensions in the future. In addition, they argue that people would save less for their retirement voluntarily, and that a statutory funded scheme is useful as it helps to offset the reduction in the size of the working age population and the increase in the number of pensioners due to population ageing. The Ministry of Finance has pointed out that if people take out the money from the statutory funded scheme in order to spend it, then their future pension will be much lower than expected. Also, there have been concerns about the pension reform - that it may not be constitutional.

According to the Estonian Constitution, the President must evaluate the constitutionality of laws passed by the Parliament. On 7 February, the President decided to return the pension reform bill to the Parliament, arguing that some aspects of it violate the Constitution (e.g. retrospectively

unequal treatment of people who have joined and not joined the scheme). The Parliament did not change it and the President has now sent it to the Supreme Court.

In addition, because of the Covid-19 crisis, the government has proposed to suspend the contributions to the mandatory funded scheme for 1.5 years which should save approximately €300 million annually (1.1% of GDP).



## Outlook and commentary

The controversial idea of making the statutory funded scheme voluntary has for a long time been a topic of discussion in the Estonian public media, as well as among policymakers, social partners and experts.

Previous analysis shows that people would save less for their retirement voluntarily than with the compulsory statutory funded scheme (Meriküll 2019).

There are several other weak points: i) the statutory funded scheme should be improved first and then made voluntary, so there would be a better basis for people to decide whether or not to opt out of the scheme ; ii) no in-depth analysis has been carried out; and iii) it would be possible to withdraw money before reaching the pensionable age and therefore less would be collected for retirement.

The authors' calculations show that the statutory funded scheme would be beneficial to people who earn more than 60% of the average salary, as their rate of return within the scheme will be higher if the current rate of return (4% nominally) continues.

The Bank of Estonia has concluded that the changes in the pension system could lead to a temporary economic growth spike, but would then be followed by a slow-down in

growth or even a recession. In addition, it would increase the risk of poverty among pensioners. The Bank of Estonia recommends that the statutory funded pension should not be made voluntary. However, if the second pillar is made voluntary, the Bank of Estonia recommends extending the minimum period of withdrawals and also suggests that the government consider ways to motivate people to continue saving money for retirement through the funded pension (Eesti Pank 2019).

### Further reading

Eesti Pank (2019), Kavandatud muudatused pensionisüsteemis suurendaksid majanduse heitlikkust. Eesti Panga lühikokkuvõtte pensionisüsteemi muutuste mõjuanalüüsist [[The proposed changes in the pension system would increase economic vulnerability. Eesti Pank brief summary of the impact analysis of changes in the pension system](#)]

ERR (Estonian Public Broadcasting) (2020), Pension reform bill passes Riigikogu vote

Meriküll, J. (2019), Kas inimesed koguksid pensionieaks vabatahtlikult sama palju kui kohustusliku kogumispensioniga [[Would people save for retirement voluntarily as much as they do under the compulsory funded pension scheme?](#)].

Piirits, M. and Laurimäe, M. (2019), Estonia's statutory funded pension scheme: a turning point? ESPN flash report 2019/39.

Riigikogu (2020), Kogumispensionide seaduse ja sellega seonduvalt teiste seaduste muutmise seadus [[Compulsory Funded Pension Reform Act](#)].

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