Czech Republic: Parliament may not approve the pension reform proposed by the Ministry of Labour and Social Affairs

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The Ministry of Labour and Social Affairs has prepared three draft laws to continue the pension system reform set out in the government's 2018 Policy Statement. The proposals are based on the work of the Commission for Fair Pensions and on an analysis made by the OECD. They have been criticised for not taking sufficiently into account the long-term financial sustainability of pensions. The upcoming parliamentary elections in early October 2021 are an added complication, making approval in Parliament unlikely. The pension reform would then have to wait for the next government.

Description

In January 2019, the Ministry of Labour and Social Affairs (MLSA) set up a Commission for Fair Pensions (hereafter "the Commission") to come up with measures that would "ensure not only a sustainable pension system, but also … provide decent and fair pensions" (MLSA 2019). The work of the Commission resulted in several recommendations for the pension system, which were backed by an OECD analysis (see below). Drawing on the Commission's work, the MLSA prepared three draft amendments to the Pension Act. In June 2021, these bills were presented to Parliament by a group of MPs.

The first one (Parliament 2021) proposes a simpler and fairer benefit formula for the statutory pension scheme. It consists of the following sub-measures:

- a substantial increase in the solidarity, basic flat-rate component of the old-age pension, from 10% to 28% of the monthly national average wage;
- a reduction in the earnings-related component of the old-age pension and greater transparency in how it is calculated;
- a reduction in the minimum period of insurance required to qualify for an old-age pension, from 35 to 25 years;
- increase in pension premiums for the self-employed; and
- a change to the indexation of old-age pensions.

The proposal would substantially strengthen income solidarity in the pension system. It is estimated that it could lead to a reduction in the at-risk-of-poverty (AROP) rate of about 4 percentage points by 2040 (compared with the estimate for 2040 based on the current pension calculation formula, i.e. 19% instead of 23%) and up to 7 pp by 2070 (16% versus 23%). This would be achieved mainly by significantly increasing the pensions received by low-income individuals (see table).

Gross replacement rates (in 2021 and projected in line with the bill) for different life-long wages and number of years of insurance (YoI)

Wage close to min. wage with 44 YoI		Wage close to national average wage with 44 YoI		Wage close to 130% of national average wage with 44 YoI		Wage close to min. wage with 30 YoI	
2021	proposal	2021	proposal	2021	proposal	2021	proposal
90.1%	97.0%	49.6%	50.7%	42.4%	43.2%	69.1%	79.1%

Note: the national average wage was CZK 35,285/€1411 monthly in Q1 2021. The minimum wage is CZK 15,200 monthly (€608).

Source: Parliament (2021:33), author's calculations.

The second amendment introduces a new plan to increase the old-age pension for each child raised (by CZK 500/€20 per month) for the parent who provided most care. The measure would lead to a slight increase in the AROP rate for men (by about 0.5-1.0 pp) and a substantial decrease for women (by about 5 pp).

The third amendment regards workers in arduous and hazardous jobs (about 1.5% of all employees) for whom there are no special rules in the current system. The amendment would allow these workers to take early retirement penalty-free, according to the principle of "reduce retirement age by 1 year for every 10 years of arduous occupation". The increased early retirement would be funded by an increase in the rate of the social contributions (from 21.5% to 26.5%) paid by employers of these workers.

Outlook and commentary

The Policy Statement of the current government sets out pension reform as a priority: "we want to take concrete steps without lengthy and futile debates" (Government 2018). In October 2019, the government commissioned OECD experts to evaluate the pension system. In November 2020, the experts submitted five recommendations (OECD 2020: 9-10) aiming at simplification and improved fiscal stability of the system, as well as addressing the eligibility rules, optimal financial structure and the role of private pension funds. The European Commission has also long been raising the issue of financial sustainability of the Czech pension system: "Most measures focused on pension adequacy but lacked safeguards to ensure long-term fiscal sustainability" (European Commission 2020: 14).

All three proposed "sub-bills" are fiscally expansionary. The Czech Fiscal Council is strongly against them (CFC 2021: 30): "The implementation of the pension reform proposal ... would lead to a greater levelling of pensions than at present. The objective of greater fairness and clarity is thus somewhat questionable. ... Compared to the baseline scenario ..., spending on old-age pensions would increase by up to 1.23% of GDP annually."

Mention should also be made of the non-standard legislative procedure. The three sub-bills were not presented to Parliament by the government but by a group of MPs. This has bypassed proper discussion within the government and with stakeholders and is partly down to the government's reluctance to seek a compromise solution against the backdrop of the upcoming parliamentary elections (early October 2021). Finance Minister Schillerová explicitly said: "there will be no pension reform before the elections" and added (Budai, 2021): "[in the MLSA's material] there are a huge number of outstanding and absolutely fundamental objections. Moreover, it is not really a pension reform because it does not address the main thing – the sustainability of the system."

The proposed sub-bills are highly unlikely to be passed. They will become a subject of the pre-election discussions and a real reform will have to wait. However, the next government should build on all the material prepared by the Commission and on the recommendations of OECD experts.

Further reading

ANAR Budai 2021, Alena Schillerová (Finance Minister): People who work all their lives deserve a dignified old age, Only in Czech

CFC, Czech Fiscal Council 2021 Report on the Long-Term Sustainability of Public Finances, Only in Czech

European Commission 2020 Commission Staff Working Document. Country Report Czechia 2020.

Government 2018 Policy Statement of the Government of the Czech Republic.

MLSA, Ministry of Labour and Social Affairs 2019 Komise pro spravedlivé důchody, *Commission for Fair Pensions,* Only in Czech

OECD 2020 OECD Reviews of Pension Systems. The Czech Republic.

Parliament 2021 Parliamentary document 1239/0. Amendment to the Pension Insurance Act, Only in Czech

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