

Grimmeisen, Simone

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## Path dependence and path departure: Analysing the first decade of post-communist pension policy in Hungary, Poland and the Czech Republic

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**Simone Grimmeisen**

**Path Dependence and Path Departure:  
Analysing the first decade of post-communist  
pension policy in Hungary, Poland and the Czech  
Republic**

ZeS-Arbeitspapier Nr. 01/2004

This paper is based on a contribution to the 1<sup>st</sup> ESPAnet conference „Changing European Societies – The Role for Social Policy“, Copenhagen, 13-15 November 2003.

## **Abstract**

Analysing the first decade of post-communist pension policy in Hungary, Poland and the Czech Republic, we find an interesting policy pattern: while the Czech government has implemented a pension reform characterised by gradual and partially parametric policy changes, Hungarian and Polish policymakers have enacted a far-reaching reform of their countries' old age security systems, involving a transformation of the previous one-pillar system into a multipillar system based on a substantial fully-funded element.

Taking up the neo-institutionalist literature, which conceives pension policy as 'locus classicus' for path-dependent policy development, the central analytical question arising is why Hungary and Poland on the one hand and the Czech Republic on the other took so different reform paths during the 90s - despite the fact that all three countries were characterised by rather similar pension systems under communist rule.

By referring to the theoretical framework provided by the multiple streams approach of John W. Kingdon, the paper develops an explanatory argument which focuses on the role of the World Bank in the agenda-setting/pre-decision phase of the pension reform processes throughout the three Visegrád countries. In a nutshell, the paper argues that the rapidly increasing problem pressure within the Hungarian and Polish pension system during the mid-90s finally opened a policy window for a far-reaching pension reform, which allowed the policy entrepreneur World Bank to couple its elaborated country-specific pension proposals to both the respective problem and policy streams. In the Czech Republic, in contrast, the crucial policy window did not open.

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## 1 Introduction<sup>1</sup>

Whereas most studies concerned with the comparative analysis of pension reform focus on the policy development within the western European welfare states, the comparative analysis of pension policy within the transition economies of Central and Eastern Europe has only recently attracted the interest of the scientific community. This growing research interest is also reflected in this paper, which by studying the recent pension reforms in Hungary, Poland and the Czech Republic seeks to contribute to a better understanding of both the policy results and the policy processes characterising the first decade of post-communist pension policy.

### 1.1 Research question

It has become a commonplace of welfare state literature to claim that reforms of mature pay-as-you-go financed Bismarckian-style pension systems will rather be characterised by “incremental cutbacks and adjustments” and a high resistance to radical reforms (Pierson 1998: 553) than by a “paradigmatic shift” (Orenstein 1998: 6). However, the story told by the developments in central Europe is more complicated: challenging the assumption that pension policy can be seen as “locus classicus for the study of path dependent policy change” (Myles/Pierson 2001: 306), a closer look at the first decade of post-transition pension policy in the Czech Republic, Poland and Hungary reveals that the latter departed from the path of a one pillar social insurance pension system based on pay-as-you-go financing while the Czech Republic continued on it.

Drawing on this observation, the central question to be answered by this paper is why the Hungarian and the Polish pension policy has developed so different from the Czech pension policy, despite the fact that all three Visegrád countries were characterised by rather similar pension systems under communist rule<sup>2</sup>.

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<sup>1</sup> For helpful comments on earlier versions of this paper I would like to thank Ellen Immergut, Martin Potucek, Heinz Rothgang and Claus Wendt. The usual disclaimer applies.

<sup>2</sup> Sharing the legacy of mature Bismarckian pension schemes (for details see Grimmeisen 2003), as well as the overall pace and depth of the political, societal and economic consolidation of the post-transition years, the countries analysed by the paper represent ‘most-similar cases’ (cf. Cichon 1995).

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## 1.2 Starting points for an explanation

In approaching an explanation for the unexpected variation of the reform outputs in the three countries, the paper commences from the fact that in Hungary and Poland besides domestic pension actors with the World Bank also an international actor was widely involved in the policy processes leading up to the pension reforms, while in the Czech Republic this however was not the case. This explanatory starting point not only reflects the strand of literature emphasising that the presence of international financial institutions (IFIs) such as the International Monetary Fund (IMF) or the World Bank in a country can have a vast impact on the reform politics and policies (cf. Mosley et al. 1991; Nölke/Stratmann 1997: 169). It also takes into account that such a connection between IFI involvement and domestic reform outputs particularly holds for the field of pension policy, for which e.g. Sarah Brooks (2001: 12f.) has found that governments which are exposed to the ideas and concepts of the World Bank have an increased probability to enact a (partial) privatisation of their pension system (see also Huber/Stephens 2000: 19; Kay 1999).

So far the literature however has found little evidence supporting the view that the World Bank “can or does compel governments to adopt a specific policy model, whether through the exercise of loan conditionality” or through its sheer presence in the country (Brooks 2002a: 15; see also Rodrik 1996: 31). Hence, I shall argue that in order to approach an explanation of the divergent pension reform outputs in Hungary, Poland and the Czech Republic it is of central importance to disentangle the complex mechanisms of World Bank influence on domestic policy reforms as well as to isolate the causal mechanism linking the presence/absence of the World Bank to the respective policy outputs. For this purpose the paper in the following draws on the multiple streams approach devised by John W. Kingdon.

## 1.3 Theoretical frame: Kingdon’s multiple streams approach

Taking up the ideas developed in the context of the garbage can model (Cohen et al. 1972), John W. Kingdon has set out a unique model of the pre-legislation process. By focusing on the phases of agenda setting and alternative specification<sup>3</sup>, Kingdon interestingly concen-

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<sup>3</sup>Agenda setting refers to the process leading to a “list of subjects to which officials are paying some serious attention at any given time. Agenda setting processes narrow the set of subjects that could conceivably occupy their attention to the list on which they actually do focus” (Kingdon 1995: 196). Alternative

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trates on those phases of the policy cycle, which Orenstein (2002: 15) has found to be crucial for the final shape of the pension reforms in central Europe.

In this respect, Kingdon's central starting assumption is that the early phases of the policy process are composed of three streams: the *policy* stream, the *problem* stream and the *politics* stream. These streams, so his argument, flow along largely separate from each other, all of them having their own dynamics and rules. At particular moments in time, however so-called *policy windows* open in either the problem or the politics stream. Following Kingdon, these open(ing) policy windows allow all actors involved in the policy process, especially entrepreneurs<sup>4</sup>, to attach their ready-made policy solution(s) to either the politics or the problem stream - or to both. It is such a coupling of the policy and the politics/problem stream, so the central argument of the multiple streams approach, which boosts the chances of an issue to rise on the government's decision agenda and thus represents a substantial step towards policy change.

By referring to this model, the paper briefly argues that the rapidly increasing problem pressure within the Hungarian and Polish pension system during the mid-90s opened a *policy window* for a far-reaching pension reform, which subsequently allowed the policy entrepreneur World Bank to couple its elaborated country-specific pension proposals to both the respective problem and policy streams. In the Czech Republic, in contrast, the respective policy window however did not open. Hence there was no predetermined link for the World Bank to enter the Czech pension reform process and to effectively advocate a radical reform.

In order to substantiate this line of argumentation, as well as the descriptive starting point claiming a divergent, path-dependending and path-departing policy development, the paper first of all shall contrast the *de jure* features of the post-communist reform in Hungary and Poland on the one hand and in the Czech Republic on the other hand. In a second step it shall then provide empirical evidence for the fact that it was indeed the opening policy window

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specification refers to the process of narrowing down the "large set of possible alternatives to that set from which choices actually are made" (Kingdon 1995: 196).

<sup>4</sup> Policy entrepreneurs are individual or collective actors who seek to promote policy innovations by selling their policy ideas and policy solutions to actors in and around government (Mintrom/Vergari 1998: 130). Compared to interests groups, policy entrepreneurs are "not content simply to push for changes at the margins of current policy settings. Rather, they seek to change radically current ways of doing things" (Mintrom/Vergari 1996: 423). In doing so, policy entrepreneurs, like business entrepreneurs, are willing to invest their "resources – time, energy, reputation and sometimes money – in the hope of a future return" (Kingdon 1995: 122).

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and the following employment of this window by the World Bank, which allowed radical reforms in Hungary and Poland while simultaneously constraining them in the context of the Czech Republic.

## 2 Hungarian, Polish and Czech pension policy during the 90s

### 2.1 The Hungarian and the Polish pension system after post-communist reform

Commencing from what can be described as mature pay-as-you-go financed one pillar pension system (Müller 1999) both the Hungarian and the Polish governments enacted far reaching pension reforms. As regards to Hungary we find that after a series of minor adjustments within the old pension system, the government in 1997 undertook a fundamental pension reform which established a “partial and step-by-step funding and privatisation of the pay-as-you-go public pension system and a concomitant modernisation of the public pillar” (Simonovits 1999: 211). At about the same time, also the Polish government paved the way for an encompassing pension reform: coming into force in January 1999, the Polish ‘Security through Diversity’ reform package launched a radically reformed pension system consisting of a notional defined-contribution (NDC) scheme<sup>5</sup> as well as of substantive fully funded elements.

As depicted in table 1, the pension reforms of the late 90s, in Hungary as well as in Poland have led to the evolution of a multipillar pension system. This, as outlined below, is based on a *mandatory first pension pillar*, set up as a reformed public, pay-as-you-go financed scheme, a *mandatory second pension pillar* based on a fully funded defined-contribution scheme<sup>6</sup> and a supplementary fully funded *voluntary third pillar scheme* – either based on occupational pension plans or on long time saving plans (Zukowski 1999: 168).

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<sup>5</sup> A notional defined-contribution (NDC) pension scheme records individual contributions but does not actually accumulate a fund. Rather, contributions accumulate according to a notional rate of return. At retirement, the accumulation in a person’s account is converted into an annuity. This however implies that benefits are fully dependent on contributions. Thus re-distributional elements typical for lots of pay-as-you-go systems disappear and the financial equilibrium of the pension scheme is strengthened as pension payments reflect more directly the movement of the revenue base (Cottarelli/Hemming 1998: 30).

<sup>6</sup> While pension benefits from a defined-benefit scheme are purely prescribed by the benefit formula, benefits from a defined-contribution scheme are calculated as sum of the periodic contributions paid into the scheme plus investment returns.



**Table 1 – the Hungarian and Polish pension system after post-communist reform**

		system financing	
		pay-as-you-go	fully funded
system operation	universal, mandatory	first pillar	second pillar
	supplementary, voluntary		third pillar

source: (Gora/Rutkowski 2000: 16).

How far-reaching the Hungarian and Polish shift towards a multipillar pension system really has been, becomes most apparent when focusing on the developments regarding the financing modus and the mechanism of benefit calculation.

### 2.1.1 Benefit calculation

As regards to the pension benefit, the payment provided by the reformed Hungarian pension system is a combination of up to three separate benefits. While the level of the *first pillar benefit* is calculated as product of the average monthly wage of actual employees and an accrual rate depending on the years of contribution payments (Kraus 1999: 292), the *second pillar pension* funds provide their members with pension benefits in the form of an annuity or in exceptional cases with a lump-sum payment. Their level are purely determined by the amount of the individual savings accumulated within the fund, the type of pension and the development of the overall mortality rate – a mode of benefit calculation which also holds for the supplementary *third pillar benefits* (MISSCEEC 1999: 106; for details see Kraus 1999: 298ff.).

Like the Hungarian pension benefit also the Polish pension benefit is composed of two to three separate benefits. Strikingly different from the Hungarian system, however, the retirement benefit from the Polish *first pillar NDC-scheme* entirely depends on the sum of contributions collected throughout the retiree's insurance life and the further life expectancy of the population at the time of retirement<sup>7</sup>. As to the *second pillar benefit*, "buying an annuity is the only possible way of using the means accumulated in a pension fund" (Zukowski 1999: 169). Similar to the second pillar benefit, benefits from the non-obligatory

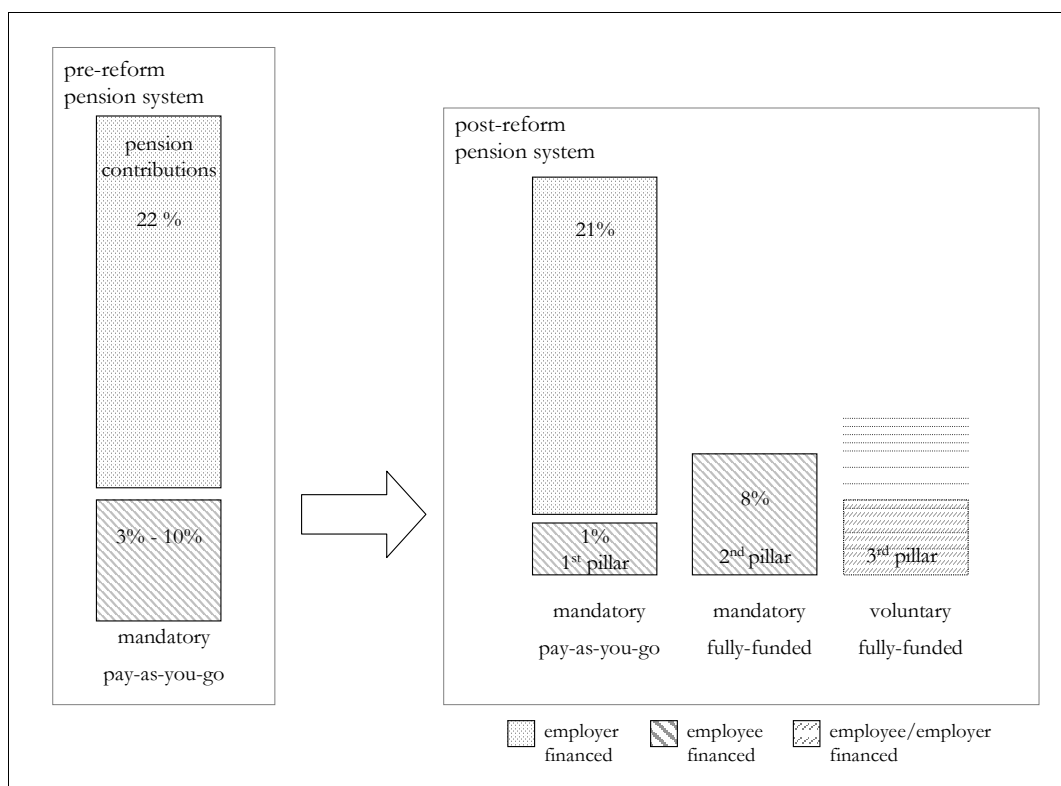
<sup>7</sup> In Poland as well as in Hungary, the mortality rate taken into account for benefit calculation is based on unisex (unified) mortality tables.

*third pillar* are tightly linked to the previous contributions and governed by the dissaving rules of the respective occupational pension plan or long-term saving scheme, which generally are similar to the Hungarian ones.

### 2.1.2 Mode of financing

When it comes to the mode of financing, the changes induced by the Hungarian post-communist pension reform are summed up in figure 1: Hungarians who opted for the reformed pension system or who are obligatorily included into it, have 22% of their gross wage channelled into the *first pillar* pay-as-you-go financed pension scheme (21% paid by the employer and 1% by themselves) and 8% of their contributions directly channelled into the fully funded *second pillar*. The supplementary *third pillar* is either purely financed by employee's contributions, benefiting from a generous tax-deduction or - when set up as an occupational scheme - by a varying combination of employer's and employee's contributions.

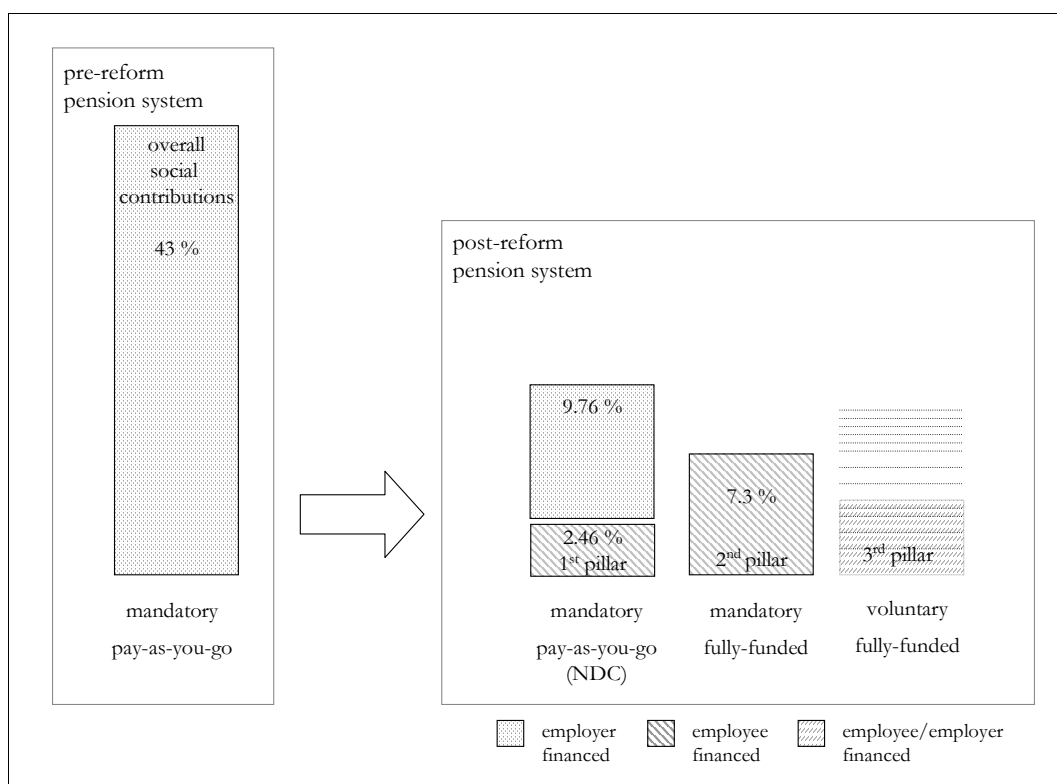
**Figure 1 - the Hungarian pension system before and after post-communist reform**



source: own depiction.

Following figure 2, in Poland 12.22% (9.76% paid by the employer and 2.46% paid by the employee) of the overall pension contributions flow into the pay-as-you-go financed *first pension pillar*, while 7.3% (purely financed by the employee) are directed into the fully funded *second pension pillar*. In contrast to Hungary however both the contributions to the pay-as-you-go financed first pillar scheme and the contributions to the fully funded second pillar scheme “are registered on individual accounts” – a central prerequisite for the establishment of the first pillar NDC scheme (Chlon et al. 1999: 20). As regards to the financing modus of the voluntary *third pillar*, the amount paid by the voluntarily insured person varies with the individual saving decision. Different from the contributions employers channel into third pillar occupational pension plans, the employees’ contributions to long-term saving schemes as well as to occupational pension plans are however not tax-deductible.

**Figure 2 - the Polish pension system before and after post-communist reform**



source: own depiction.

## 2.2 The Czech pension system after post-communist reform

Despite the fact that the Czech<sup>8</sup> pension system had a very similar starting point into the post-communist period, as outlined by Katharina Müller (1999: 131), in contrast to Poland and Hungary during the 90s “no systemic change has been envisaged” in the Czech Republic. In fact, several incremental reform steps mainly implemented in the first half of the 90s have led to the evolution of a rationalised old-age security system which - as shown by table 2 – is based on two pillars: a *mandatory* public, pay-as-you-go financed *first pillar* and a *voluntary* fully funded supplementary *second pillar* based on private pension funds (Mácha 1999: 248).

**Table 2 – the Czech pension system after post-communist reform**

		system financing	
		pay-as-you-go	fully funded
system operations	basic, mandatory	first pillar	
	supplementary, voluntary		second pillar

source: (Gora/Rutkowsik 2000: 16)

### 2.2.1 Benefit calculation

The monthly *first pillar pension* within the reformed Czech pension system is defined as sum of the universal flat-rate base component and the product of the number of years of insurance and 1.5% of the standardised personal assessment base per year of insurance, calculated for the last 16 years of employment. Interestingly the Czech first pillar scheme still exhibits a rather high degree of income redistribution: while contributions are paid from full earnings, the earnings are not fully taken into account when it comes to the calculation of benefits (Mácha 1999: 249). As regards to the voluntary *second pillar scheme*, the pension benefits however exclusively depend on the sum of the individual contributions and the shares of the pension funds profit paid during the years the pensioner was part of the respective plan/programme.

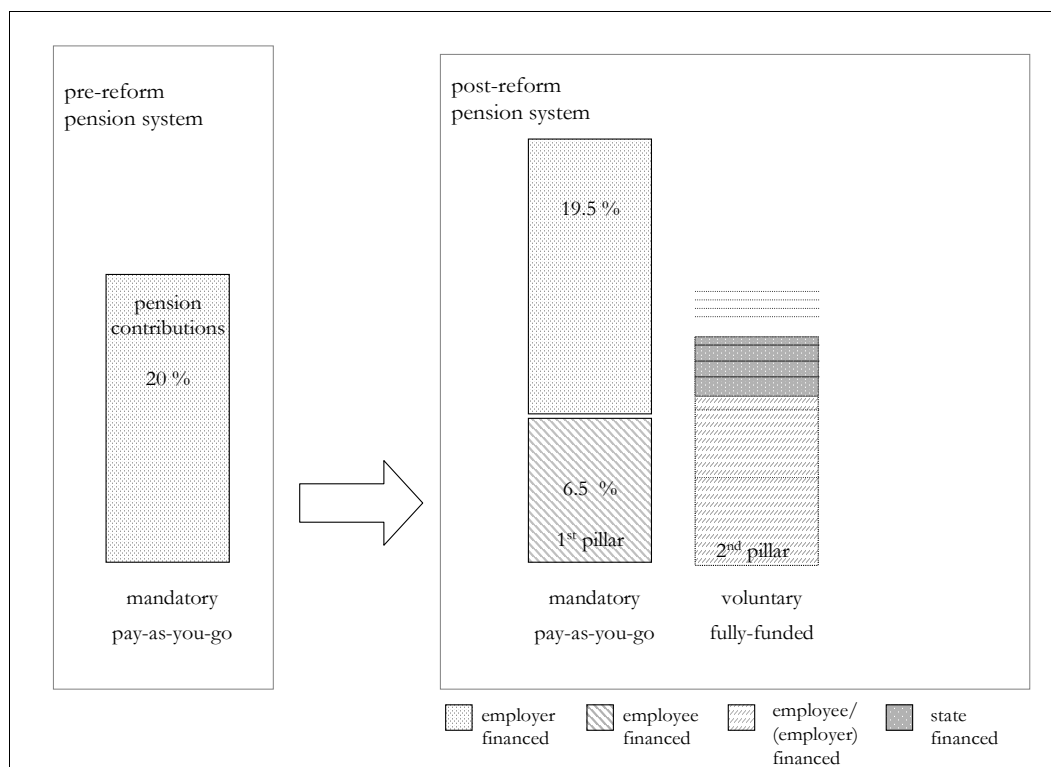
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<sup>8</sup> The description of the Czech pension system before reform refers to the pension system of Czechoslovakia. Before the Czech and the Slovak Republic officially separated on January 1<sup>st</sup> 1993, however no substantial pension reform has taken place.

### 2.2.2 Mode of financing

When focusing on the mode of financing, figure 3 indicates that the mandatory part of the Czech post-communist pension system, namely the *first pillar scheme* is based on a pure pay-as-you-go principle with a pension contribution amounting to 26% of the insured person's gross wage. While the employee pays a premium equivalent to 6.5% of the gross wage, the employer's share amounts to 19.5% of the gross wage. As to the fully funded but voluntary *second pillar*, the insurant has to pay a minimum but uncapped contribution which is then complemented by a monthly state subsidy depending on the level of the insurant's own contribution. Employers may also contribute to an employee's account – a commitment which however is not tax-deductible (for details see Jelínek/Schneider 1999: 261).

**Figure 3 - the Czech pension system before and after post-communist reform**



source: own depiction

### 2.3 The puzzling empirics of the post-communist pension reforms

Summing up the first decade of post-communist pension reform in the three Visegrád countries, we can conclude that so far only the Czech policy-makers have opted for “gradual and partial parametric changes” (Lasagnabaster et al. 2002: 6) or a simple rationalisation of the

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existing pay-as-you-go scheme. In contrast to its neighbouring systems, the mandatory part of the Czech pension system has not shifted “to funding at the expense of the public pension tier” (Müller 2002: 294). Taking up the argumentation describing the Czech pension reform as “continuously evolutionary process without revolutionary changes” (Král 2001: 215), thus there are good reasons to perceive the Czech reform outputs as path dependent (also see Cottarelli/Hemming 1998: 23).

Contrary to the development in the Czech Republic, the reform outputs in Hungary and Poland however represent a ‘path departure’ from the legacy of communist pension policy (cf. Myles/Pierson 2001: 331). First of all, this path departure is indicated by the fact that the mode of operation of the respective pension schemes lately very much changed from defined-benefit towards defined-contribution. Secondly, the path departure of the Hungarian and Polish pension policy is also indicated by the replacement of the communist one pillar pension system by a multipillar pension system in which the state draws back from pension provision in favour of pension provision by the private sector – a shift in the trajectory of Hungarian and Polish pension policy which in the long run will lead to the fact that income maintenance through public pension benefits alone will no longer be possible (cf. Hinrichs/Kangas 2003: 581).

Moreover there are good grounds for arguing that the policy developments we have witnessed in Poland and Hungary represent a ‘Hallian’ “third order change”<sup>9</sup>, as in both countries not only the setting and the instruments of pension policy have been changed but also the pension policy’s “overarching goals” (Hall 1993: 278). While the Czech pension system continues its commitment to the goal of equalisation and redistribution (cf. Mácha 2002: 82; Potucek 2001: 94), the multipillar systems established in Hungary and Poland represent an increasing shift “from the goals of redistributing income and risk through collective insurance towards those of efficiency and macro-economic growth through mandatory savings” (Brooks 2002b: 493). Following the explicit governmental desire to utilise the pension systems in order “to raise the domestic save rate and bolster the local capital markets” (Madrid

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<sup>9</sup> “We can identify three distinct kinds of changes in policy (...) First, [a change of] the levels (or settings) of the basic instruments. We can call the process whereby instrument settings are changed in the light of experience and new knowledge, while the overall goals and instruments of policy remain the same, a process of first order change in policy (...) When the instruments of policy as well as their settings are altered in response to past experience even though the overall goals of policy remain the same, [changes] might be said to reflect a process of second order change (...) Simultaneous changes in all three components of policy: the instrument settings, the instruments themselves, and the hierarchy of goals behind policy(...) occur rarely, but when they do occur as a result of reflection on past experience, we can describe them as instances of third order change” (Hall 1993: 278-279).

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2002: 4; cf. also Brooks 2001; Huber/Stephens 2000), Hungary and Poland have recalibrated their pension systems along the World Bank principle to ‘protect the old *and* to promote growth’<sup>10</sup> (World Bank 1994a: 3, italics S.G.). This change in the goals of the Hungarian and Polish pension policy, so my argument, became manifest in the partial privatisation of the mandatory part of the pension system.

Consequently, the Hungarian as well as the Polish case illustrates that a far-reaching pension reform - including a shift towards a multipillar system and a partial privatisation of the system of old age security – is also feasible in the context of an existing mature pay-as-you-go scheme characterised by a large implicit pension debt (Brooks 2002b: 505; Palacios/Rocha 1997: 43). In this respect the developments in Hungary and Poland challenge a core assumption of recent welfare state literature, namely that once the path is set for a pay-as-you-go financed pension system this considerably limits the number and the range of policy options, by pointing the policy-reformers to look “for political feasibility, in some pre-determined directions” (Bonoli 2000: 41)<sup>11</sup>.

### **3 Multiple streams and the post-communist pension reforms**

As to the paper’s explanandum – the divergent pension reform outputs in Hungary and Poland on the one hand and in the Czech Republic on the other hand – I have proposed to draw on the theoretical framework provided by the multiple streams approach. A suggestion which the following part of the paper shall now bring together with the empirics of the first decade of central European pension reform.

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<sup>10</sup> “Regarding the hierarchy of these objectives, the World Bank’s leading pension expert, Estelle James, makes clear that the multi-pillar model should be introduced mainly because of efficiency and growth considerations, referring to a better provision of old-age security as a mere secondary argument” (Müller 1999: 26).

<sup>11</sup> This, so the reasoning, is due to the fact that once established and matured a pay-as-you-go financed Bismarckian pension system causes the evolution of a dense regulatory framework which forces individuals to make significant commitments and investments that cannot be easily reversed (‘acquired rights’). As a consequence, the pension system renders the political and real costs of a fundamental change – even to a potentially more efficient pension system – far higher than the costs of continuing along the adopted path (Pierson 1996: 175). Not only does a mature pay-as-you-go financed pension system exhibit remarkable sunk costs, which are generated by the initial policy decision in favour of a pay-as-you-go scheme, it also causes a ‘double payment problem’ when being transformed into a fully funded scheme. This however provokes a *lock-in-effect*, which is reinforced by the fact that mature pension systems tend to establish their own bases of support by creating ‘spoils’, which “provide a strong incentive for actors to mobilize in favour of programmatic maintenance or expansion” (Pierson 1992: 361; also see Baier 1977).

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### 3.1 The essentials of Kingdon's multiple streams approach

#### 3.1.1 Problems, policies and politics: three independent streams

As briefly introduced above, the multiple stream approach starts from the assumption that the process of agenda setting/alternative specification is composed of three independent streams which are flowing along vastly independent from each other.

The first stream constituting the pre-legislation phase is the so-called *policy stream*. Resembling what Kingdon (1995: 116) calls the “policy primeval soup”, this first stream contains ideas and policy proposals generated by bureaucrats, legislators, academics or by specialists, epistemic communities and policy entrepreneurs. Once developed, the policy ideas and policy proposals floating around in the policy stream are debated, re-drafted, altered and tried out in order to “soften up” the policy community and the broader public; to make them receptive to a new idea (Kingdon 1995: 127ff.; Zahariadis 1999: 76). Despite the fact that the sheer amount of ideas and proposals within the policy stream is quite high, according to the multiple streams approach only those policy ideas and policy proposals, which appear to be technically feasible and which conform to the core values of the policy-makers have a long-term survival perspective.

Besides the policy stream, Kingdon secondly identifies the *problem stream*. The second stream forming the pre-legislation process comprises information about problems or more precisely, about conditions that become defined as problems or pressing issues because “actors believe they should do something to change them”<sup>12</sup> (Kingdon 1995: 198).

Independently of policy development and problem recognition, in a third stream, political events flow along (Kingdon 1995: 198). Without going into detail, the *politics stream* as third component of the agenda setting/alternative specification process is thereby composed of such dimensions as public mood, pressure group campaigns, election results, partisan or ideological distributions of Parliament, changes in the administration and turnover of key personnel or policy-makers.

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<sup>12</sup> “There is a difference between a condition and a problem. We put up with all manner of conditions every day: bad weather, unavoidable and untreatable illness, pestilence, poverty, fanaticism. (...) Problems are not simply the conditions or external events themselves; there is also a perceptual, interpretive element” (Kingdon 1995: 109f.).



### 3.1.2 Coupling of the streams in the context of policy windows

According to Kingdon (1995: 178), none of the streams are sufficient by themselves to place an issue firmly on the decision agenda<sup>13</sup>. However at critical moments in time so-called *policy windows* open an opportunity to couple or join the three streams together and thus to enact agenda and consecutively policy change. As already briefly outlined above, such policy windows are opened either by compelling events in the problem stream or in the politics stream (Zahariadis 1999: 77). Consequently there are *problem windows* or *political windows*.

Generally, so the argument, open(ing) policy windows lead decision-makers to intensify their search for policy solutions and policy ideas within the policy stream. However, not only decision-makers make use of a policy window: also policy advocates and policy entrepreneurs try to take advantage of it (Kingdon 1995: 175). Anticipating that “the chances for a problem to rise on the decision agenda are *dramatically* increased if a solution is attached”, these policy entrepreneurs use policy windows in order to couple their ‘pet policy solution(s)’ to the respective problem and/or to the politics stream (Kingdon 1995: 143). While coupling the streams policy entrepreneurs however not only need to be skilful in attaching their ‘pet policy solution’ to the pressing problems or in finding politicians receptive to their ideas – they also must react instantly as policy windows are scarce and small and additionally do not stay open for a long time (Zahariadis 1999: 87).

### 3.2 A policy window in the problem stream: the pension issue as an increasingly pressing policy problem

When analysing the case of pension reform in the three countries under observation, we instantly realise that the policy window preparing the ground for a coupling of the three streams opened in the problem stream.

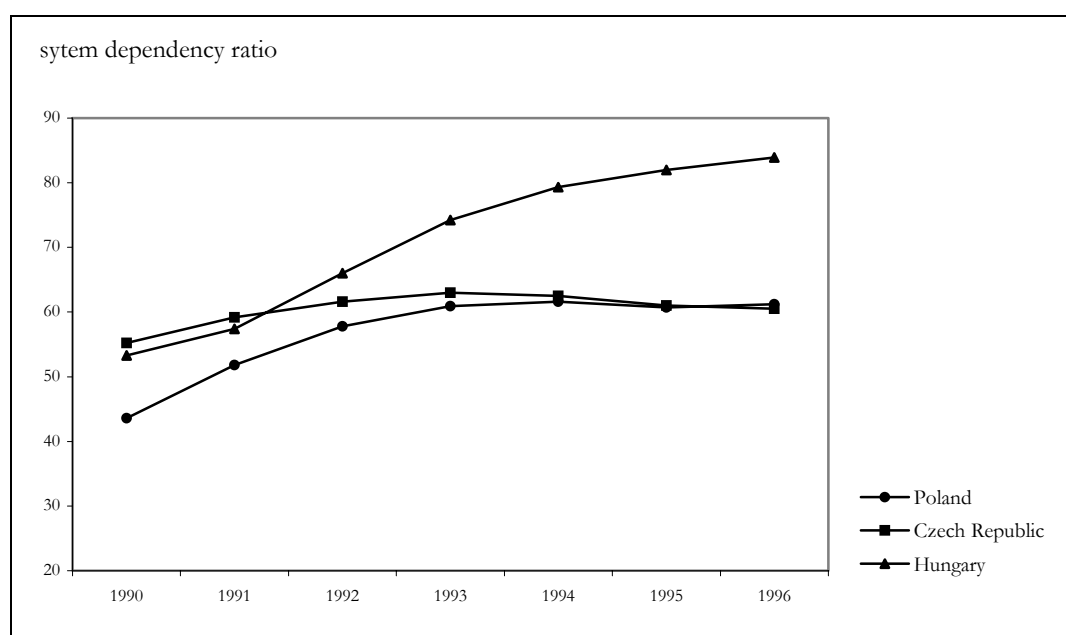
First of all, from the early 90s onwards, the Hungarian and the Polish labour market suffered from a rapid increase in unemployment as well as from falling labour force participa-

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<sup>13</sup> Kingdon (1995: 166, 142) distinguishes between governmental agenda and decision agenda. While the former is “the list of subjects to which people in and around government are paying serious attention at any given point in time”, the “decision agenda includes only those subjects, that are up for an active decision, that are moving into position for some sort of authoritative decision, such as legislative enactment or the presidential action”. Consequentially, “being on the decision agenda, of course, does not insure enactment of favourable bureaucratic decision, but it is a more active status than being on the governmental agenda”.

tion rates. Interrelated with the fact that both countries tried to absorb the unemployment problems by introducing generous early retirement and disability regulations, the labour market problems finally led to both an increase in the numbers of pensioners and a falling number of contributors (Schrooten et al. 1999: 278f.). This growing imbalance is reflected by the rising system dependency ratio of the Hungarian and Polish pension system. As depicted in figure 4, the system dependency ratio – describing the relation of persons receiving pension benefits to those persons paying pension contributions – continuously rose in Hungary throughout the 90s. The Polish system dependency ratio, on the other hand, did not rise as steeply as the Hungarian one and also slowed down its growth by mid of the 90s. In the Czech Republic in contrast, the system dependency ratio, based on a low level of unemployment and comparatively high and stable labour force participation rates, however only grew very moderately during the first post-transition years<sup>14</sup>.

**Figure 4 – development of the system dependency ratio**



source: (Schrooten et al. 1999); own depiction.

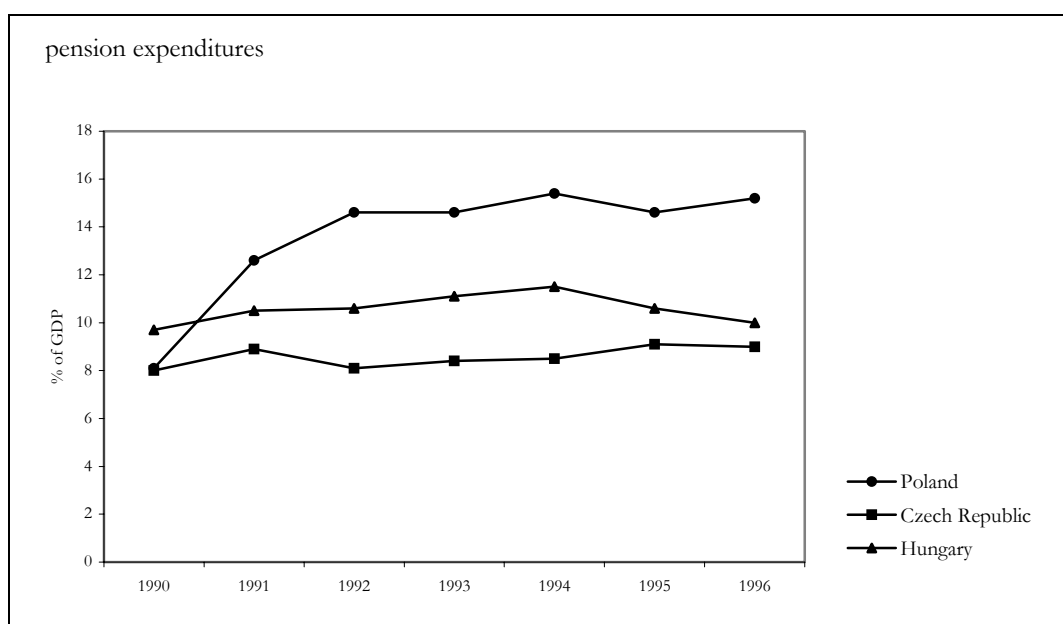
As rising system dependency ratios stand for falling contributions and simultaneously increasing benefit payments, the developments outlined above, finally resulted in a financial gap within the Hungarian and Polish pension system, which was additionally widened by the continuously high level of pension benefits in both countries (Fultz/Ruck 2000: 5). A

<sup>14</sup> As the demographic changes have not begun to be felt in the three countries, I will not take into account the development of the old age dependency ratio (see Lodahl/Schrooten 1998).

fact that did not apply to the Czech pension system, in which policy-makers during the first post-transition years managed to cut back both the relative level of pension benefits and the replacement ratios (Cottarelli/Hemming 1998: 19).

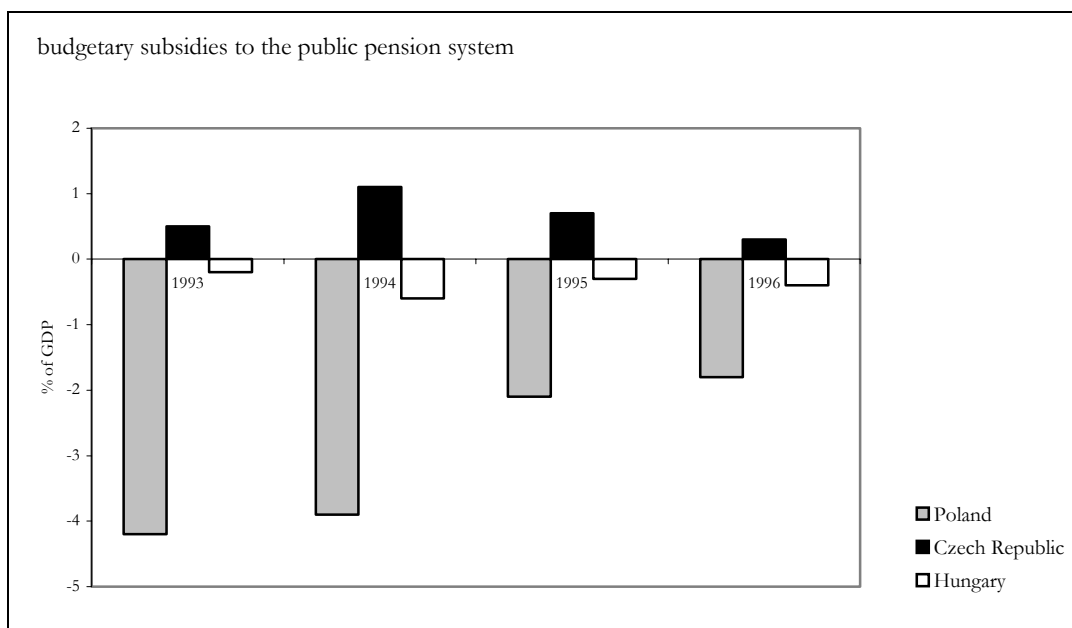
The growing fiscal imbalance of the Hungarian and Polish pension systems manifested itself not only in the development of the pension expenditure, which increased until the mid 90s (see figure 5). Additionally, as indicated by figure 6, the Hungarian as well as the Polish pension funds have been highly dependent on cross-subsidies from the general state budget, while the Czech state social security fund remained in surplus until 1996 (Mora 2000: 67).

**Figure 5 – development of pension expenditures**



source: (Lodahl/Schrooten 1998); own depiction.

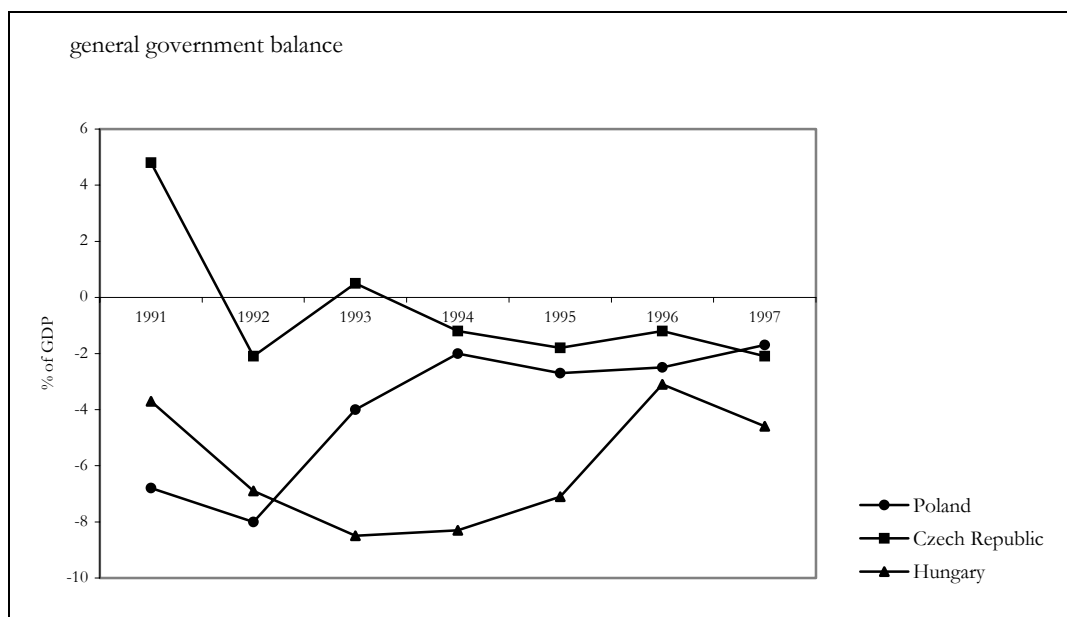
**Figure 6 – development of the budgetary subsidies to the public pension system**



source: (Schrooten et al. 1999); own depiction.

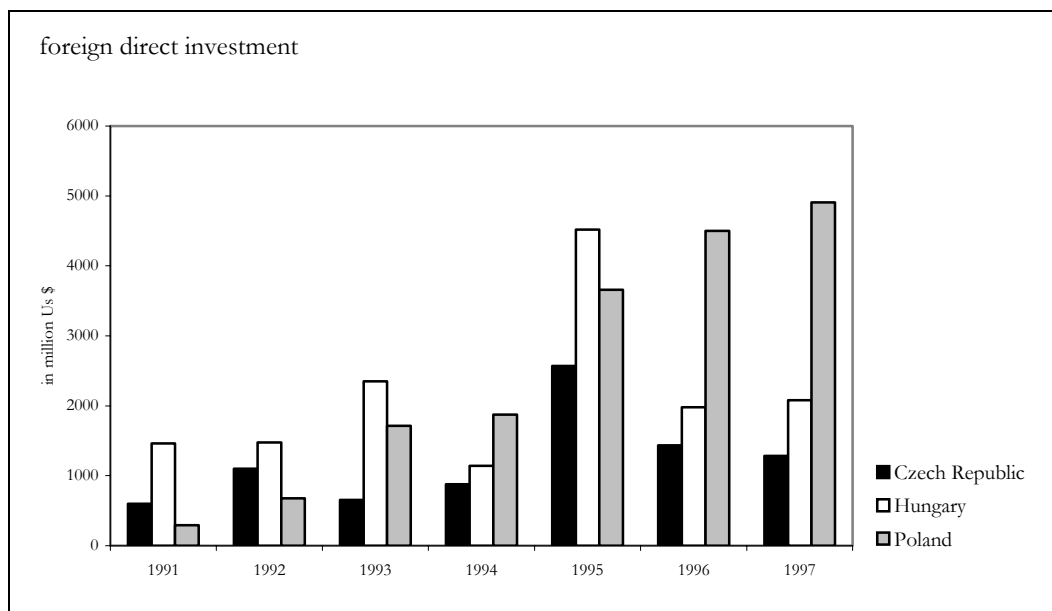
Furthermore, the Hungarian and Polish pension systems also suffered from the comparatively high inflation rates of the early and mid 90s. Facing a twofold or respectively fourfold inflation rate compared to the Czech Republic, in Hungary and Poland the pension issue became all the more pressing because the purchasing power of the pension benefits deteriorated more rapidly - a development which was complemented by the lack of secured adjustment mechanisms (Cottarelli/Hemming 1998: 6; Horstmann/Schmähl 2002: 29f.).

Beside the growing financial imbalances and the negative impact of the inflation development, the problems of the Hungarian and Polish pension systems were also accelerated by the unfavourable macroeconomic setting in the two countries. As indicated by figure 7, in the early post-transition years, both countries were characterised by severe budget imbalances. Consequentially, the governments also lacked the slack financial resources allowing them to implement short term adjustment measures in order to absorb the immediate fiscal problems of the pension system.

**Figure 7 – development of government balance**

source: (Cottarelli/Hemming 1998); own depiction.

Finally, the pension issue became increasingly pressing in Hungary and Poland because both countries/governments heavily relied on foreign direct investment (see figure 8).

**Figure 8 – development of foreign investment**

source: (World Bank 1999); own depiction.

In this situation of an increasing macroeconomic as well as pension-specific problem pressure, by mid of the first post-communist decade, both the Hungarian and the Polish governments feared that a non-reform of their pension system would not only deepen their fis-

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cal crisis but also lead to a diminished confidence of the international financial community in the countries – causing even more severe consequences for the economic development (Gedeon 2001: 233ff.; Madrid 2002: 3). Concluding the empirical evidence provided by this section, with the terminology of the multiple streams approach I thus argue that in Hungary and Poland during the mid of the 90s a pension-specific policy window opened in the problem stream.

The Czech pension system, in contrast however remained in a relatively good shape until the late 90s. Following the World Bank (2001: 36), this comparatively positive development can be put down to fact that “the Czech Republic has not experienced the rapid increase in unemployment and the collapse of revenue collection that has afflicted other transition economies and the surge of disability pensions seen when the old age pension age was increased”. As during the 90s the pension issue did not become severely pressing in the Czech Republic (see also Mácha 2002; Vecernik 2000: 6; Vylitova 2002: 15), I thus argue that contrary to Hungary and Poland, no problem window opened in the Czech Republic.

### **3.3 The policy entrepreneur World Bank and the working out of a policy solution**

However, as outlined by Kingdon (1995: 142), for a policy issue to rise up to the decision agenda it is “not enough that there is a problem, even a quite pressing problem”. If no solution for the problem is produced by the policy stream and subsequently ‘pasted into’ the problem window, so his argument, the subject neither gets firmly established on the decision agenda nor rises in the first place (Kingdon 1995: 178). Only a “worked-out, viable proposal, available in the policy stream, enhances the odds that a problem will rise on a decision agenda” (Kingdon 1995: 195). Thus, in order to successfully pave the way for policy change, when a problem window opens, it needs to be filled with specific proposals from the policy stream. These proposals - as said above - are usually not only developed by decision-makers, bureaucrats, or policy experts, but also by policy entrepreneurs.

While promoting policy change policy entrepreneurs, according to the multiple streams approach, simultaneously pursue two lines of action: firstly they work out policy solutions and ‘soften up’ the policy community and the larger public, secondly they also try to utilize open policy windows in order to push their policy proposals to the fore and attach them to the problem and/or the politics stream. As described by Kingdon (1995: 181), policy entrepreneurs “lie in wait for a policy window to open” allowing them to couple their elaborated

‘pet policy solutions’ with either the problem or the politics stream or, most preferably, with both. In order to take optimal advantage of an open(ing) policy window, policy entrepreneurs first and foremost must have their policy proposals ready-to-go when a window opens (Kingdon 1995: 170, 182).

Taking up this argumentation, on the remaining pages I shall provide evidence underlining the assumption that in Hungary and Poland the decision agenda was set for a far-reaching pension reform because the World Bank – acting as principal (pension) policy entrepreneur in the region<sup>15</sup> – not only provided an elaborated and ‘softened up’ policy proposal but also successfully utilised the open problem window to attach its policy proposals for a multipillar<sup>16</sup> pension reform to the respective problem streams.

### **3.3.1 The role of the World Bank in the Hungarian pension reform**

As to the involvement of the World Bank in the Hungarian pension reform, the Bank’s influence started around 1992, when the international financial institution initiated a first series of pension seminars throughout the central European countries. In one of those seminars also the Hungarian pension experts were confronted with the idea of ‘privatising’ the mandatory part of the pension system – an idea which they however dismissed as “sheer lunacy, being foreign not only to the Hungarian but also to the European tradition” (Ferge 1999: 7).

Despite some movements behind the scenes, involving both the World Bank and the IMF actively pressing for a “genuine pension reform” (Ferge 1999: 4), during the following two years, the World Bank was not an exposed actor within the field of Hungarian pension policy. In 1994 and 1995, the Bank’s involvement manifested itself mainly in the publication of the first World Bank country study on Hungary. Under the heading ‘Structural Reforms

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<sup>15</sup> To a minor extent, also the IMF was involved into the post-communist pension reform processes (cf. Cottarelli/Hemming 1998) – from the non-financial side also the ILO (cf. Cichon 1995; Fultz/Ruck 2000; ILO CEE 2002) the OECD (cf. Marossy 2001; Mihalyi 1999), and the EU were concerned with the topic of pension policy in Central and Eastern Europe.

<sup>16</sup> Claiming that pension systems based on a single public pay-as-you-go financed pillar “have spun out of control in the middle- and high income countries”, the World Bank (1994a: 1) promoted and advocated a pension system which “optimally consists of a mandatory, publicly managed, unfunded pillar and a mandatory but privately managed funded pillar, as well as of supplemental, voluntary, private funded schemes” (Holzmann 2000: 12). Only such a multipillar system, so the Bank’s argument, allows to circumvent the alleged weaknesses of a public single-pillar schemes, namely the weak contribution-benefit link, its labour market distortions, its proneness to political manipulation as well as its inability to efficiently cope with the demographic challenges.

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for Sustainable Growth’, the report reiterated the Bank’s pension ideology, stating “that in Hungary’s present economic situation, there is much to argue for the creation of a fully funded second pillar - especially the incentives for greater savings and the dynamic effect on capital markets” (World Bank 1995: 40). Emphasising that “the implementation of a well-articulated transition from a public pay-as-you-go system to a multi-pillar system lies at the core of successful pension reform”, the World Bank country study proposed the splitting of Hungary’s single public pension tier into two mandatory pillars consisting of a flat rate citizen pension and a fully funded earnings-related scheme (World Bank 1995: 38ff.).

At about the same time, the World Bank – on request of the Ministry of Finance – also became directly involved in the process of Hungarian pension reform (Ferge 1999: 8). Directed by the economist Roberto Rocha, the Bank’s Budapest office put the pension working group of the Ministry of Finance “in touch with a large network of pension experts all over the world and helped to provide two-way translation of documents and comments on specific issues” (Nelson 1998: 245). From 1996 onwards, the Hungarian World Bank office furthermore was heavily involved in funding and assisting the newly established inter-ministerial pension working group<sup>17</sup>. Beside the fact that the World Bank representatives provided much of the working group’s technical capacity, the Bank’s financial involvement also allowed the employment of numerous foreign pension experts and thus contributed to the fast and professional drafting of the highly detailed legislative proposal (Orenstein 1998: 38f.). Interestingly, in the subsequent public debate on the proposal, the advisors of the World Bank then however “chose to not take an active role in public discourse, in order to avoid the perception that the reform was foisted on Hungary by the World Bank” (Roberto Rocha as quoted in Orenstein 1998: 40).

### **3.3.2 The role of the World Bank in the Polish pension reform**

As regards to Poland, the World Bank’s active involvement in the process of pension reform started in 1994, when Bank officials introduced their ideas for a radical, Chilean-style

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<sup>17</sup> In early 1996, the Hungarian government established an inter-ministerial working group on pension reform led by István Györffy, a commissioner of the Ministry of Finance. Responsible for the elaboration of the technical and legal details of the envisaged reform, the working group was dominated by civil servants from the Ministry of Finance and supported by the World Bank’s Budapest Office. As outlined by Müller (1999: 79), within the inter-ministerial working group the delegates of the Ministry of Welfare were responsible for issues concerning the first pillar, while the delegates of the Ministry of Finance were responsible for issues concerning the second pillar.



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pension reform in the context of a World Bank seminar held in Poland. Highly reluctant to the vast transition costs of a radical privatisation of the pension system, the Polish policy-makers attending the seminar however met these ideas with strong reservations (Golinowska 1999: 180).

Only a few months later, the World Bank's country study on Poland however discarded the Chilean model as not suitable for Poland and instead proposed to "simultaneously reform the existing system and introduce a new, multi-tier system, to be phased in over the next 15 to 20 years" (World Bank 1994b: 34). At about the same time the Bank's multipillar approach was presented during a meeting of World Bank experts with Polish scientists and trade unionists, in which the World Bank officials Estelle James and Michal Rutkowski presented their experience from the successful implementation of a multipillar pension system in Latvia.

As we learn from the analysis of the further policy process, the controversial and dragging Polish pension reform debate continued throughout the following two years – with "one of the triggering points for a more constructive work on the pension reform" (Bialas 2001: 26) being a conference held by the Polish Institute for Labour and Social Affairs at which the World Bank in April 1996 presented its elaborated suggestions for a Polish multipillar pension reform.

However only with the establishment of the so-called 'Office of the Plenipotentiary for Social Security Reform' in summer 1996, the World Bank finally became directly involved in the process of Polish pension reform. Complying with a request of the Polish government, the Bank assisted in the setting up and funding of the Plenipotentiary's office, which was exclusively dedicated to the drafting and implementation of a comprehensive pension reform. In the following, the Polish World Bank official Michal Rutkowski was appointed head of the office. Firmly committed to the Bank's multipillar blueprint, Rutkowski took over the "responsibility for the day-to-day running of the office and for the drafting of reform proposals" (Orenstein 1998: 48). Following their conviction that the central European countries need to accelerate their reform processes, Rutkowski as well as the World Bank's pension division provided extensive networking and technical support for the preparation of the draft bill, which cumulated in the 'Security through Diversity' reform framework published in July 1997 (Golinowska 1999: 183; Nelson 1998: 245).

### 3.3.3 The role of the World Bank in the Czech pension reform

When analysing the policy process underlying the Czech pension reform we can conclude that the World Bank was a “notable absentee” (Müller 1999: 144; see also Vecernik 2000: 6; Vylitova 2002: 14f.). In contrast to the Hungarian and Polish cases, there was no domestic actor calling in the World Bank expertise in the Czech Republic. Moreover, the Czech prime minister Václav Klaus himself was very sceptical about the employment of any international expertise, arguing that the “reform processes taking place in Eastern Europe are unique, and that it is up to domestic experts who have a better understanding of the country’s situation to design and to implement policy reforms” (Blejer/Coricelli 1995: 42). Hence, while recently one can observe attempts of the World Bank to participate in the field of Czech pension policy<sup>18</sup>, as regards to the first decade of post-communist pension policy the literature has revealed no evidence for a such an influence (Mácha 2002: 106).

### 3.3.4 Summary: the World Bank as policy entrepreneur

Drawing on the case studies presented above, it becomes clear that the policy entrepreneur World Bank, from the early 90s onwards was highly involved in the development of an appropriate policy solution for the pressing pension problem in Hungary and Poland.

While the literature reveals that the detailed proposals for a comprehensive pension reform in Hungary and Poland have been finalised by mid of the 90s, it is rather sketchy when it comes to the detailed shape of the concerning policy proposals. However when triangulating the secondary literature and the World Bank country studies themselves it is reasonable to conclude, that both pension policy blueprints widely followed the lines of the multipillar model launched in ‘Averting the Old Age Crisis’ and hence advocated a pension system based on a flat rate component and on the introduction of a substantial private fully funded pillar (Orenstein 1998: 71; Queisser 2000; World Bank 1994b; World Bank 1995).

In its role as policy entrepreneur, the Bank however not only devised detailed policy proposals for the Polish and the Hungarian pension reform, it simultaneously made substantial efforts to ‘soften up’ both the “pension policy community (...) and the larger public - getting them used to the new ideas and building acceptance for their proposal” (Kingdon 1995:

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<sup>18</sup> In its 2001 country study on the Czech Republic, the Bank requested a fundamental pension reform and proposed the introduction of a notional defined contribution scheme and/or a fully funded pillar (Lasagnabaster et al. 2002; World Bank 2001: 38ff.).

128; Mintrom 1997: 740f). Drawing on its good contacts to domestic policy-makers, its financial resources and its acknowledged expertise in the field of social security, the World Bank disseminated its policy ideas in numerous workshops, seminars throughout the central European region and in discussions with politicians, bureaucrats, scientists and the larger public.<sup>19</sup> In order to demonstrate the technical feasibility of its policy proposal, the World Bank also held training seminars bringing together policy-makers from different transition economics and providing them with technical details of the multipillar proposal and reform evidence from other countries.<sup>20</sup> By pointing out the problems of the existing pension system and simultaneously stressing the benefits of the multipillar system the policy entrepreneur tried to convince both decision-makers and the public that its ideas are good for economic growth as well as for the long term sustainable development (Fox 1996: 32ff.; Madrid 2002: 11). As outlined above, during this process of discussing and softening up, the proposals for the Hungarian and Polish pension reforms have been revised and adjusted to the county-specific setting several times.

Summing up the empirics of the reform processes in Hungary and Poland, the last paragraphs have emphasised that the policy entrepreneur World Bank - by mid of the 90s - had two ready-made, discussed and revised country-specific policy proposals for pension reform at hand. Additionally, the description has shown that around the same time the general public as well as the pension policy community has been softened up and convinced of the technical feasibility of the project. This was not only done by the “countless studies that trumpeted the merits of market-oriented reforms” but also by the seminars, PR work and the public debate supported by the policy entrepreneur World Bank<sup>21</sup> (Madrid 2002: 11).

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<sup>19</sup> “We try to encourage open discussion in the country of what are the goals of our proposals, are these goals appropriate for the country? We go with our counterparts to parliament at an early state, to discuss the project and what the goals are. We, with our counterparts, will talk to the press about what are the goals and what we are doing. We support the counterpart's effort to have and open discussion about their social policy.” – statement by World Bank official Louise Fox (1996: 38).

<sup>20</sup> “Although the motive and design of the pension reform did not change as a result of that intense camp, it did wonder to develop an understanding and good working relationship between the political protagonists of the reform” - statement of a key participant in Uruguay's pension reform, who had been trained in one of these World Bank seminars (seen in Brooks 2000: 12).

<sup>21</sup> In this respect the multiple streams theory provides a link to the transformation literature, which increasingly sees the World Bank as “conveyor belt of ideas” and as “most important external source of ideas and advice to developing-country policymakers” (Gavin/Rodrik 1995: 332). Opposing the conditionality argument, this literature claims that the World Bank “can exert considerable influence on the design and sometimes on the pace and timing of institutional reforms. That influence however, is less seen as a result of conditionality than of high-quality analyses of sector and sub sector issues, ability to point to good and bad experiences with similar reforms in other countries and ongoing dialogue with government

### 3.4 The policy entrepreneur World Bank and the coupling of the streams

As outlined by Kingdon (1995: 182), “the policy entrepreneur who is ready, rides whatever comes along” - that is he makes use of every opening policy window. Thus, once policy entrepreneurs have successfully hooked their policy proposal to the problem or to the politics stream, they will attempt to join all three streams - knowing that “the chances for enactment [of their policy proposal, S.G.] are considerably enhanced if they can complete the circle” (Kingdon 1995: 204). Consequently, a policy entrepreneur who has accomplished a partial coupling of the problem and the policy stream will also try to enlist political allies and to find politicians/bureaucrats receptive to its ideas (Kingdon, 1995: 182; 175).

Drawing on the empirical evidence presented so far, it becomes clear that the policy entrepreneur World Bank around the year 1994/1995 possessed a ready to go policy proposal for both the Hungarian and the Polish pension reform. Commencing from that point in time, the World Bank, so my argument, persistently tried to hook its policy solutions to the problem, respectively to the politics stream in the concerned countries. Due to the fact that by mid of the decade the increasingly pressing problems of the Hungarian and the Polish pension system caused a policy window to open in the problem stream, the Bank’s attempts to couple their policy solution to the respective problem streams were very quickly successful.

Generating severe fiscal implications, the aggravating pension problems in Hungary and Poland however not only opened a problem window, but they simultaneously reinforced the interest and the influence of the Ministry of Finance in the respective pension reform processes, giving the finance ministers and their administration an increasing stake in the pension issue (Müller 1999: 168f.; see also Chlon-Dominczak/Mora 2001; Nelson 1998: 243). These changes in the executives’ portfolio arrangements provided a uniquely receptive climate for the Bank’s policy proposals: both the Hungarian and the Polish Ministry of Finance not only shared the macroeconomic momentum but also the underlying values of a multipillar reform (Brooks 2002b: 497; Gedeon 2001: 230). Hence, by mid of the 90s, the policy entrepreneur World Bank took advantage of the political receptivity of both the Hungarian and Polish finance ministries and “pushed its package of problem and policy solution” (Kingdon 1995: 202) in order to join it to the politics stream. Following the argument of Kingdon (1995: 195), that “the probability of an item rising on the decision agenda is

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officials and (increasingly) with non-governmental groups” (Nelson 1996: 1557; see also Madrid 2002: 11).

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dramatically increased if all three elements – problems, proposals and political receptivity – are coupled into a single package”, I argue that it was this joining of all three streams by mid of the first post-communist decade, which allowed the World Bank to firmly establish the issue of a comprehensive multipillar pension reform on both the Hungarian and Polish decision agenda.

Apart from moving the issue of Hungarian and Polish multipillar reform into the direction of a legislative decision, the World Bank also managed to control the subsequent process of alternative specification/policy formulation. For this the World Bank invested a vast amount of monetary and intellectual resources in order to push its pet alternative – a multipillar pension system based on a (partial) privatisation of the mandatory scheme – to the forefront of the set of decision alternatives in Hungary and Poland. Based on its skilful performance as policy entrepreneur, which particularly manifested itself in the proposals put forward by the Hungarian and the Polish Ministry of Finance, the World Bank proposal, in both countries, emerged as winner from the process of alternative specification and commitment-building (Orenstein 1998: 38) and therefore paved the way for a far-reaching policy change – also because no further institutional or partisan veto-points occurred in the further line of the legislative process (cf. Grimmeisen 2003: 45ff.).

#### **4 Conclusion**

Thus, combining the steeply increasing “problem load” (Schludi 2001: 7) of the Hungarian and Polish pension system and the evidence from the case studies with Kingdon’s theoretical approach, it appears that it was firstly the opening of a problem window and the subsequent coupling of all three streams into a single package and secondly the policy entrepreneur World Bank vastly dominating the process of alternative specification, which has successfully paved the way for the far-reaching changes in the Hungarian and Polish pension system during the end of the first post-communist decade.

As no policy window opened in the Czech Republic, also no opportunity opened up for the World Bank to enter the domestic pension reform process and to effectively advocate its pension template. Additionally the closed problem window inhibited the coupling of all the three streams and thus prevented the setting of the Czech decision agenda for a comprehensive pension reform. Drawing on Kingdon’s theoretical framework, it is therefore no sur-

prise that the outputs of the post-communist pension reform in the Czech Republic remained rather incremental while Hungary and Poland enacted radical reforms<sup>22</sup>.

In this respect the paper has tried to show that domestic policy-makers facing severe macro-economic problems and a high pension-specific problem load, assisted by skilled policy entrepreneurs, can even move the grey giants of the welfare state.

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<sup>22</sup> In the Czech Republic however, not only the policy window remained closed: during the 90s, the policy entrepreneur World Bank did also not develop an elaborated, softened up pension reform proposal. As regards to the multiple streams approach this development hints firstly to the point that the problem and the policy streams are not flowing along as independent as pretended by Kingdon and secondly to the point that policy entrepreneurs in anticipation of the future opening of a policy window may accelerate their efforts in drafting a ready to go proposal (on this critique see also Zahariadis 1999).

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