POLICY BRIEF IDEA

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What Further Reforms Does the Czech Pension System Require?[1]

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This policy brief summarizes the main issues with the current pension system in the Czech Republic and analyzes the reforms implemented by Petr Fiala's government in 2022–2024. Its aim is to provide a factual framework for debate on the sustainability of the pension system with regard to fiscal constraints and demographic trends. The text explains the key tensions between three possible reform paths – reducing pensions, increasing the retirement age, and raising contributions – and evaluates legislative changes in terms of their impact on public finances. In conclusion, this brief highlights open questions: the future of the indexation mechanism, incentives for longer work activity, the role of foreign workers, and the potential for further development of funded the third pillar.

The current pension system in the Czech Republic is based almost entirely on pay-as-you-go financing (the so called first pillar), and its structure has not changed significantly since the mid-1990s. It has long faced issues such as low merit[2], insufficient clarity for the public, unjustifiable disparities among otherwise identical contributors to the pension system across cohorts[3], between employees and the self-employed, and weak development of funded (capital-based) savings.

In its reform agenda for 2022–2024, Petr Fiala's government placed particular emphasis on increasing the financial sustainability of the pension system, responding to challenges including high inflation and resulting high indexation, an aging population, and growing general pressure on public budgets, including defense and healthcare. The government introduced a higher retirement age, reduced future pension entitlements and indexation, tightened early retirement rules, and increased minimum contributions for self-employed persons, which reduced the advantage for self-employed persons in terms of their return on contributions paid into the system.

All governments can and must choose between three fundamental options to prevent growing deficits in a pay-as-you-go pension system, known as the "pension trilemma". In response to demographic aging, governments may reduce pensions relative to the average wage, increase the retirement age, and/or raise contributions to the system relative to GDP. If any future government decides to reverse the reform measures introduced by Petr Fiala's administration, it must clearly state which of these alternatives it will pursue. Otherwise, it must find funding for the pension system elsewhere, because population aging cannot be stopped.

Despite the relatively average intensity of pension expenditure in the Czech Republic within the EU27 – 9% of GDP – it should be noted that this figure is reduced by the fact that Czech pensions are not taxed, and the actual burden on public budgets is therefore approximately average in the European context, with the truly difficult demographic situation still being ahead of us.

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2 Merit is the relationship between previous income (contributions to the pension system) and the amount of the pension.

3 In this context, a cohort refers to a group of pensioners who applied for retirement in the same period.

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