Country Report

POLAND

Current pension system: first assessment of reform outcomes and output

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The Institutional Architecture

The inefficient, extremely fragmented (250 working categories enjoyed varying early retirement rules during the 1990s) and fiscally unsustainable old age pension system that Poland inherited from socialism was systemically overhauled in 1998.[1] A multi-pillar structure consisting of a multi-tiered first pillar (combining a state-run PAYG Notional Defined Contribution first tier and a privately-managed fully-funded second tier) and still rather underdeveloped occupational and individual savings schemes substituted the old single pillar state-run system. Despite being the ‘Security through Diversity’ package at the forefront of pension innovation, it contained two major flaws: not only the reform reinforced the male breadwinner model, which did not disappear from Poland even during socialist times, but also the flexibilization and short-termism of Polish employment clashes with the new system, which instead encourages workers to yearn for stable, long-term contractual relationships. Hence, Polish retirement rules put vulnerable citizens at risk of social exclusion due to: low levels of actuarially strict mandatory provision, insufficient protection of women outside marriage and the underdevelopment of supplementary insurance.

Poverty alleviation is in Poland served by providing **social assistance benefits** to households whose income falls under a certain threshold (PLN 567.08 in 2009). This non-contributory scheme is unrelated to the age of the recipient, as is not the social pension, which is payable to all adults that had been recognised as completely incapable of work due to impairment of body functions. In 2008, 240.5 thousand persons received it.

The **first (state and mandatory) pillar** includes three tiers. The *zero* tier is a guaranteed minimum pension, which is being paid to persons who reached the statutory pensionable age and have accumulated at least 20/25 contributory years for women/men. The guarantee is means-tested and is hence triggered if the total pension falls below a certain threshold. The difference is topped up from the state budget. In 2009, minimum guaranteed benefits amounted o PLN 675.10, which equalled to 46% of the average old-age pension or 53% of the minimum salary.

The new *first* and *second* tiers started paying out pensions since January 2009. Two old-age pension systems have been operating in Poland since 1999. The old, defined-benefit pension scheme applies to people older than 50 on the date of entry into force of the reform, the new one to those younger. These are subdivided into two groups: i) people below 30, compulsorily insured in both the public and private schemes; ii) people aged 30 to 50, who chose whether to adhere to the Notional Defined Contribution scheme only or to both. The latter obtained a moratorium of ten years to retire early, if they did not pick the funded pillar and if they fulfilled all requirements under old rules before 2009. Women retiring during 2009-2013, who did not join private schemes, were instead offered a smooth transition between the two systems, consisting of a mixed old-age pension partly under old and partly under new rules.

The first and second tiers are financed through individual contributions (19.52% of gross wages) that are equally split between the employer and employee (9.76% each). Participation in the second, funded tier implies that of the employee’s contribution, 7.30% is diverted to the Open Pension Funds. The ceiling to contributions and pensionable earnings is set at 2.5 times average earnings projected for a given year in the state budget law, i.e. PLN 95,790 in 2009.

The *first* tier is PAYG, state-run and adopts a Notional Defined Contribution formula. Hence,

[1] This country fact-sheet does not deal with the Agricultural Social Insurance Fund (*Kasa Rolniczego Ubezpieczenia Społecznego*, KRUS), an unreformed and highly problematic institution covering the pensions of farmers.

12.22% of contributions flow into individual notional accounts.
The notional capital's accrual rate (valorization) is 100% of the real wage bill growth (75% before 2004), thereby bringing the system's finances in line with both productivity and labour force participation growth. At retirement, the notional assets are converted into annuities using unisex life expectancy tables provided by the Central Statistical Office (*Główny Urząd Statystyczny*, GUS).
Since 2008, indexation is carried out once a year, on 1 March. The indexation rate is mixed: 80% of price inflation in the preceding calendar year, increased by at least 20% of real growth of average monthly earning. Indexation of pensions above the minimum level is negotiated with the Tripartite Committee.
In order to stabilise the contribution rate when baby-boomers retire or other demographic fluctuations happen, the government established a Demographic Reserve Fund.
Early retirement was abolished under the new arrangements. However, special working categories have been included into a bridging pensions system (starting in 2009). Circa 270 thousand people working in special conditions will receive a bridging pension up to five years before retirement age (hence at 55/60 for women/men with 20/25 years of contributions and 15 year at least working under special conditions). This benefit will be financed from the state budget. Deferred retirement is allowed without limits for both tiers. Work during retirement is possible, but if work income is above 70% of the average wage, pensions are reduced; they are suspended if it exceeds 130% (in 2008, the two limits were, respectively PLN 24,216.90 and PLN 45,345.60).
Despite the technical prowess of the first tier, this contains severe distributional inequities. 'Security through Diversity' draws an overoptimistic picture of the adequacy of the multipillar system for future retirees. Following the authors' assumptions, the new schemes are less generous for shorter accumulation periods, yet more than proportionally reward postponed retirement. The second pillar contributes towards entry benefits roughly as much as the first one due to higher returns.
These projections are unreliable. Subsequent evaluations reject the assumptions as excessively confident, given the economic slowdown in 1998-2004 and the fact that people enjoying long uninterrupted careers are increasingly rare. In particular, even high-income employees should buy supplementary private insurance in order to achieve acceptable income maintenance levels. However, only a tiny fraction is voluntarily insured.
The new system is particularly ill suited for atypical workers and women. Increased flexibility and abuse in the Polish labour market clashes with a pension system that encourages workers to yearn for stable contractual relationships. Atypical forms of employment guarantee lower protection standards than permanent employment. Part-time employment does not yield adequate income levels; fixed-term contracts increase the likelihood of unemployment spells. Civil law agreements are unlawful if they are stipulated with own-account workers, who are in reality fake self-employed and so have lower contribution bases (declared income with a lower limit of 60% of the average wage – in practice, almost all self-employed declare this minimum).
Women have cumulative disadvantages. The male breadwinner model has been considerably strengthened as state infrastructure for elderly- and child-care collapsed. Marriage is encouraged to improve insurance against old age. Finally, the lower statutory retirement age, coupled with similarly shorter accumulation, decreases the replacement rate by almost 30%.
The ongoing discussion on the introduction of redistributive elements yielded some tangible results. In 2004-2005, wage valorisation was introduced and full assessment bases started to be used for older pensions. Since 2009, childrearing women have their bases calculated on minimum wages and not on the much lower social allowance. These measures signal the attentiveness of Polish policymakers, yet they are clearly insufficient.

The *second* tier has a shared private-state management; it is fully funded and invested on the market. Compulsory affiliation means that the majority of younger workers are now covered, i.e. over 14 million by mid-2009. The 14 existing Open Pension Funds (*Otwarty Fundusz Emerytalny*, OFE) accumulated since 1999 assets worth PLN 152.7 billion. The year 2008 marked the worst performance in their decade of existence, a staggering -14.15% nominal rate of return. Otherwise, yields were fairly positive but swinging widely – since 2000 the average annual nominal rate of return was 8.76% and the real one 5.13%.

The Law on Annuities, adopted by the Parliament after 10 years of debate at the beginning of 2009, states that assets are converted into the single annuity using unisex life tables at retirement age (not before 65). Women, who retire before that year will receive payments based on programmed withdrawal until 65. Annuities will be increased by 90% of returns from reserves. At the minimum annuities are price-indexed and based on unisex life-tables, thereby again redistributing towards women.

The funded tier has some problems that should be overcome at once. First, there are Draconian investment limits (5% maximum in foreign assets), which limit risk diversification. Second, there are minimum return guarantees that breed herding behaviour. Third, the funds failed to self-regulate and hence, the Financial Supervision Authority (KNF) had to cap them, thereby emasculating cost competition. Fourth, despite a costly and long information campaign an increasing number of new labour market entrants fail to choose a fund and are therefore automatically assigned.

In addition to the mandatory pillar, policymakers introduced occupational and individual pension plans in 1999 and 2004. Employee Pension Funds (*Pracowniczy Fundusz Emerytalny*, PFE), Employee Pension Programs (*Pracowniczy Program Emerytalny*, PPE) and Personal Pension Accounts (*Indywidualne Konto Emerytalne*, IKE) constitute the **second** and **third pillars**. These are both fully funded and privately managed. Regrettably, their role in private pension provision is still marginal, in particular because high contribution rates for mandatory pensions and the existence of OFEs crowd out individual and occupational schemes for all but the most well off employees.

There were only five PFEs (genuine occupational pension plans) in Poland in late 2009, covering 59 thousand insured. By December 2008, just 1% of registered enterprises offered 1,079 PPEs. Less than 3% of total employees participated, i.e. 325 thousand workers. Two reasons account for the scarce popularity of these plans. First, Polish employers did not adopt any mechanisms to prevent poaching, especially due to high unemployment. Second, tax incentives are insufficient. In April 2004, PPEs were simplified, liberalising contributions, unblocking investment and widening tax exemptions, but the effects were limited.

IKEs represent a complement to PPEs. The government grossly overestimated the number of opt-ins, expected to reach 3.5 millions in a few years. By June 2009 there were 833 thousand insured (some 5% of total employees) with assets worth PLN 1.8 million, which means that the downward trend in the number of members that started in 2007 is continuing. The reasons for the scarce appeal are again inadequate tax incentives, penalties for early withdrawal and high overall social security contributions.

Information needs

Starting from 2006, ZUS has been obliged to provide all insured persons (born after 31 December 1948) with annual information about contributions recorded on their individual accounts, amount of initial capital after indexation and about the hypothetical old-age pension amount. In addition to regular statements sent to KNF, each OFE sends to its members a written annual statement about the funds accumulated on the member's account, dates of premiums paid in that period and transfer payments, as well as on translation of those premiums and transfer payments into accounting units, and about the results of fund's investment activity.

The Administrative Structure

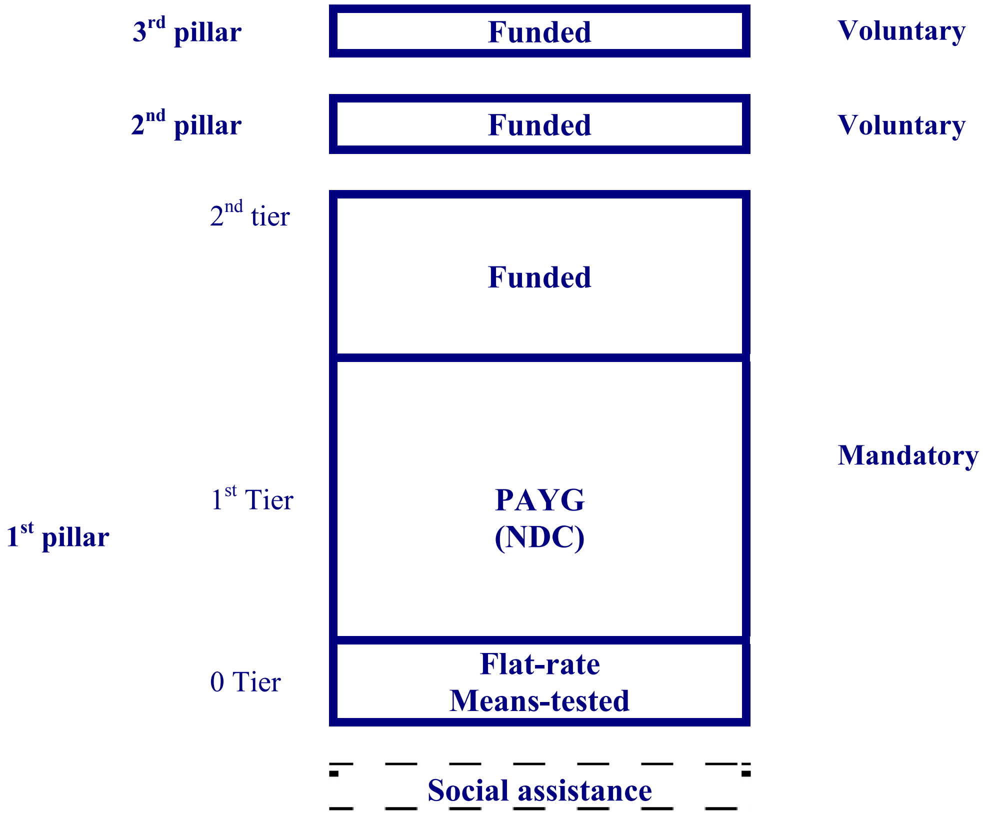
The Polish pension system is under the responsibility of the Ministry of Labour and Social Policy for employees, the Ministry of Agriculture and Rural Development for farmers, and by the Ministries of Defence and of Internal Affairs for soldiers and policemen. The Social Insurance Institution (*Zakład Ubezpieczeń Społecznych*, ZUS) administers pensions for workers but not for farmers. The ZUS covers old-age pensions, disability and survivors pensions, sickness and work accidents. These are financed through the four sub-funds of the Social Insurance Fund (*Fundusz Ubezpieczeń Społecznych*, FUS). Farmers are instead covered by the Agricultural Social Insurance Fund (*Kasa Rolniczego Ubezpieczenia Społecznego*, KRUS). Social partners have a minor direct responsibility in managing the system being part of the supervisory boards within each institution.

Open Pension Funds' management is shared among public and private institutions. Asset management and investment is supervised by the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*, KNF). A Pension Fund Society (*Powszechne Towarzystwo Emerytalne*, PTE), a separate legal entity, manages each pension fund. Yet, private pension contributions are collected and allocated by ZUS, which acts as a clearinghouse.

Assessment and Future Challenges

The Polish pension reform of 1999 modernized the fiscally and intellectually broke socialist pension system, rendering it fiscally sustainable and basically self-balancing, at the expense, however, of future social adequacy and poverty alleviation targets. Atypical working categories have to be in all respects better protected (perhaps with a Beveridgean basic pension) and women need to work more, in less precarious positions and have greater access to childrearing facilities. The combined gaps in service and income replacement policies, pose them at great risk of income exclusion in old age. Adding to these, there are governance problems with mandatory funded schemes and supplementary pensions are insufficiently developed.

Figure 1 The Main Pillars in the Polish Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed, 2nd tier state-regulated and privately managed, contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Poland

Contribution rates	Employer	Employee
Total (1st pillar)	9.76%	9.76%
1st tier	9.76%	2.46%
2nd tier	-	7.30%

Supplementary schemes	PPEs, PFEs
Contribution rates	Variable, depending on scheme
Coverage (of employees)	3%
Assets in EUR bln (2007)	na
Taxation	Taxed Exempt Exempt
Investment principles	Quantitative Restrictions

Theoretical replacement rates	Gross	Net
	1st pillar total	1st pillar total
2005	63.2	77.7
2050	35.7	43.9

SILC income 2004	Total	Male	Female
Relative income of 65+	1.089	1.204	1.022
Aggregate rep. ratio	0.585	0.658	0.573

Eligibility retirement age	
Old age	60/65 for women and men
Early retirement	55/60 for those eligible to bridging pensions
Deferred retirement	No limit

Indexation	
Guarantee pension	80% prices and 20% wages
Income pension	Prices

Public pension spending (as % of GDP)	2004	2020	2050
	13.9	9.8	9.3

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