The pension system in Poland
From mid 1990s until today

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World Bank Pension Core Course
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Outline

1. Context: 25 years of economic transition in Poland
2. Evolution of the employees’ pension system in Poland in the past 25 years
3. Farmers’ pension system developments and challenges
4. What next?
5. Lessons learnt
Zmiany struktury wieku ludności Polski w perspektywie wieku

Changes in the age structure of the Polish population
Fertility remains low and life expectancy increases.
Population ageing

FIRST SIGNS OF POPULATION AGEING

Changing age structure of the population
Falling fertility and lower number of births
Extending life expectancy
Population growth close to zero
Labour market

- Economic activity (15+)
- Employment ratio (15+)
- Unemployment rate (15-74)
Levels of income

INDEX OF REAL GROSS SALARIES

INDEX OF REAL GROSS PENSIONS
EMPLOYEES’ PENSIONS (RED)
FARMERS’ PENSIONS (GRAY)
Economic growth
Evolution of the employees’ pension system in Poland in the past 25 years
Stages of pension system changes in Poland

1. Pension system in early 1990s: restoring adequacy
2. Shaping the pension reform in Poland – „Security through diversity”
3. 15+ years of reform implementation
4. Pension system after economic and fiscal crisis
Pension system after economic transition

1. Early retirement further widespread to absorb excess workers due to jobs destruction in the transforming economy

2. Level of benefits below adequacy due to high inflation level
   ➢ recalculation (revalorisation) of all pensions in 1992
   ➢ Introduction of permanent pension indexation anticipating inflation levels
   ➢ New pension defined-benefit pension formula
     ➢ linking pensions to individual wage level and employment history (1.3% of wage for each year of work)
     ➢ redistributional part (24% of average wage)

3. New pension system for farmers – KRUS to maintain coverage and pension income among individual farmers
   ➢ Benefits depend mainly on the number of years worked in agriculture
Need for pension reform in 1990s

Pension system development from early 1990s led to its unsustainability in long run:
- Contribution rate: 45% of payroll
- Replacement rate: 70-80% of wage
- Average retirement age: 55 for women and 60 for men
- Pension expenditure reached 14-15% of GDP in mid 1990s

Problems in pension system:
- Short-term: rising deficit, widespread early retirement, actuarially imbalanced
- Long-term: population ageing caused by approaching retirement of baby-boom generation and falling sharply (to lowest-low) fertility rate

Current adjustments to pension systems turned out to be ineffective, the pension reform became inevitable
The pension reform concept elaborated between 1996 and 1998
The reform implemented in 1999
Moving from mono-pillar PAYG DB system to
Multi-pillar scheme:
  ◦ Mandatory first pillar: non-financial defined contribution (12.22% of wage)
  ◦ Mandotary second pillar: financial defined contribution (7.3% of wage)
  ◦ Voluntary third pillar: employee pension plans, individual retirement accounts (2004), individual retirement protection accounts (2009)
Coverage:
  ◦ Mandatory NDC+FDC: born after 1968
  ◦ Choice between NDC+FDC or NDC only: born between 1949 and 1968
  ◦ PAYG DB: born before 1949
Shaping the pension reform in Poland – „Security through diversity”

Projected reform outcomes:

- Regaining financial stability in the long run: close to actuarially balanced pension formula
- Transition costs financed from privatisation revenue, savings in pension system (limiting early retirement) and from the state budget
- Incentives to postpone retirement decisions
- Reduced generosity of pension benefits – towards actuarial fairness
- Clear separation of redistribution and income replacement role:
  - Contributions for selected periods financed from the public funds
  - Minimum pension guarantee (top-up) financed from the state budget
Implementation issues

➢ Introduction of the new IT system with delays
➢ Errors in individual contribution records
➢ Longer calculation of initial capital

➢ Administration is crucial for the smooth implementation of the pension reform
First tier
ZUS - Correctness of information

Source: ZUS
Financing of the pension system

Initial administrative problems causing arrears in contributions transfers to FDC

High pension system deficit adding to transition costs

- Postponed withdrawal of early retirement
- More generous pension indexation
- Falling contribution revenue
Returns on individual accounts

Rates of return in pension system fluctuating

- Overall positive real return in FDC
- Low NDC returns during the first year
- Much lower variance of overall return vis a vis NDC and FDC only
Expectations and facts about financing transition costs

Expected privatization revenues were used also for other purposes.

Postponed savings in PAYG part.

Relaxed fiscal policy reduced room to finance transition cost, especially after 2008 economic slowdown.

<table>
<thead>
<tr>
<th>Year</th>
<th>Old-age savings</th>
<th>Taxes</th>
<th>gg Debt</th>
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<td>2006</td>
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<td>2007</td>
<td>1.20</td>
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<td>2008</td>
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<td>2009</td>
<td>1.18</td>
<td>0.05</td>
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<td>2010</td>
<td>1.17</td>
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<td>2011</td>
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<td>2012</td>
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<td>0.05</td>
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<td>2013</td>
<td>1.14</td>
<td>0.05</td>
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<tr>
<td>2014</td>
<td>1.13</td>
<td>0.05</td>
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<tr>
<td>2015</td>
<td>1.12</td>
<td>0.05</td>
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</table>
Early retirement struggle

- The reform plan was to reduce early retirement
- During first years: early retirement expanded through pre-retirement transfers
- Possibility of early retirement extended from the end of 2006 till the end of 2008
- The final plan of "bridging pensions" introduced from 2009
- Quick reduction of early retirees and rise of employment rate
Retirement age

➢ Traditionally different retirement age of men and women: 65 and 60

➢ Initial reform proposal of equalising retirement age not supported by the politicians

➢ Gradual equalisation of retirement age to 67/67 approved from 2013

➢ In 2017 the raise of the retirement age reversed: estimated inflow of new retirees: 417 thousand people, including 312 thousand after October
The new pension system in Poland: implementation experience

**INITIAL PLAN:**
- NDC + FDC operating from 1999
- Indexation of pensions close to CPI
- Diversification of FDC investment strategies from 2004
- Early retirement removed from 2007
- Transition costs financed partially through removal of early retirement

**REALITY:**
- Initial plans implemented, but some elements remained not solved (annuities, multi-funds)
- Indexation close to wage growth until 2004
- No diversification of FDC investment strategies
- Early retirement prolonged by two years, additional early retirement rights for men granted in 2008
- Increased social insurance deficit due to reduction of disability contribution from 2008
Fiscal situation and reform reversal

May 2011:
➢ Contribution rate to FDC reduced to 2.3% in May 2011
➢ 5% of wage recorded on quasi-NDC account (indexed to GDP growth)

February 2014:
➢ contribution at 2.92%
➢ assets invested in government bonds (9% of GDP) transferred to PAYG scheme and redeemed
➢ FDC parts opt-out and opt-in in specified time slots (first slot: April-July 2014, second in 2016
➢ assets from FDC transferred gradually to PAYG 10 years prior to retirement – net transfer from pension funds
Decomposition of the changes of pension funds’ assets (bln PLN)

(-) decline of the net assets =
(+) contributions plus interest
(-) fee from contributions
(-) safety slider
(+) financial result before management fee
(-) management fee
(-) other financial flows

Source: Financial Supervision Committee
## Structure of the investment portfolio

<table>
<thead>
<tr>
<th></th>
<th>XII 2016</th>
<th>III 2017</th>
<th>VI 2017</th>
<th>IX 2017</th>
<th>XII 2017</th>
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<tr>
<td><strong>foreign investment</strong></td>
<td>8.96%</td>
<td>8.34%</td>
<td>7.53%</td>
<td>7.82%</td>
<td>8.07%</td>
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<tr>
<td><strong>bank deposits</strong></td>
<td>76.40%</td>
<td>78.64%</td>
<td>79.26%</td>
<td>79.10%</td>
<td>79.59%</td>
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<tr>
<td><strong>national equity</strong></td>
<td>7.31%</td>
<td>6.29%</td>
<td>6.72%</td>
<td>6.36%</td>
<td>5.95%</td>
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<tr>
<td><strong>national debt instruments</strong></td>
<td>7.34%</td>
<td>6.72%</td>
<td>6.48%</td>
<td>6.72%</td>
<td>6.39%</td>
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</tbody>
</table>

**Values:**
- **XII 2016:**
  - Foreign investment: 8.96%
  - Bank deposits: 76.40%
  - National equity: 7.31%
  - National debt instruments: 7.34%

- **III 2017:**
  - Foreign investment: 8.34%
  - Bank deposits: 78.64%
  - National equity: 6.29%
  - National debt instruments: 6.72%

- **VI 2017:**
  - Foreign investment: 7.53%
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  - National debt instruments: 6.48%

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- **XII 2017:**
  - Foreign investment: 8.07%
  - Bank deposits: 79.59%
  - National equity: 5.95%
  - National debt instruments: 6.39%
Consequences of the reversal

Sustainability of public finance
- In short run: public finance debt remaining below 55% of GDP
- In long run: increased implicit pension debt and higher pension expenditure in the future, when demographic dependency rates worsen significantly

Adequacy of pensions
- Increased risk level (due to changed proportions of FDC and NDC)
- Potentially lower returns (historically higher average returns in FDC and less investment in equity)

Reduced role of pension funds as domestic institutional investors:
- Potential impact on the volatility of the Warsaw Stock Exchange
- Smaller involvement of pension funds on the primary market
Sustainability and adequacy of pension system as of today

Reversal of pension reforms caused by a set of socio-economic factors, including most importantly
- poor fiscal situation
- rising pressure from current pension system expenditure

Performance of pension funds had little impact on reversal decision

Change in contribution split:
- Increases the risk in the pension system
- Potentially reduces future pension levels
Sustainability and adequacy of pension system as of today

Reduced social trust towards pension system, undermining the generational contract and social sustainability

- Government can take away pension saving
- Multiple pension accounts: NDC, quasiNDC, FDC, 2 types of individual retirement accounts with different tax treatment, Employee Pension Plans (still underdeveloped)

Population ageing puts significant pressure on labour market development which will affect pension system
Disability pensions
1999 changes in disability legislation

➢ New definition of disability:
  o Focused on ability to work (full or partial inability to work)
  o Moving away from the notion of health detriment

➢ Change in the disability assessment
  o Developing network of assessment doctors employed in the Social Insurance Institution
  o Moving away from assessment by doctors’ committees
Disability pensions – reverse of trend after 1998 change of legislation

**NUMBER OF DISABILITY PENSIONS PAID**

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**NUMBER OF NEW DISABILITY PENSIONS GRANTED**

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Farmers’ pension system
Farmer’s pensions in Poland

Separate scheme for individual farmers from end of 1970s
Separate administration of the system – KRUS from early 1990s.

From the beginning
- Heavy role of subsidies from the state budget
- Initially 70 per cent of expenditure, but then increasing to more than 90% of expenditure, due to inflation reason
- Flat-rate contributions and benefits
  - Contributions more than 8 times lower than for self-employed outside agriculture
  - Benefits at the level around 120%-140% of minimum pension
Number of pensioners was larger than insured until mid-2000s

Share of farmers in the employment declines leading to lower number of insured and also pensioners

Increase in the number of insured due to legal changes: access to KRUS insurance for smaller farmers
ZUS and KRUS in Poland, 2015

- **Insured**
  - Insured ZUS: 14.82
  - Insured KRUS: 1.38

- **Pensioners**
  - Pensioners ZUS: 7.27
  - Pensioners KRUS: 1.20

- **Budget subsidy**
  - State budget subsidy ZUS: 42,065.70
  - State budget subsidy KRUS: 17,037.38
Simplification of administrative procedures

Farmers pension system (KRUS):
- Flat-rate contributions and flat-rate benefits
- Heavily subsidised by the state budget

In Poland self-employed outside agriculture (in ZUS):
- Do not have to file monthly reports (based on annual information, Social Security Institution automatically generates necessary reports)
- They can provide documents in paper form (for employers who employ more than 5 people electronic format is required)
Pros and cons of separate farmer’s scheme

**PROS**

Ensuring coverage for rural population

Providing significant part of cash income for low-income farmers

Administration adjusted for the needs of clients
  ◦ Simplified reporting
  ◦ Support in paper work

**CONS**

Farmers do not pay taxes
Subsidising low-income and high-income farmers in the same way
  ◦ Polarised structure – overrepresentation of framers in 1st and 10th deciles
  ◦ Tax-payers from outside agriculture subsidise high-income farmers

No changes after EU accession, despite significant increase of farmers income due to CAP

Reduces mobility on the labour market

Attractive for evasion from general ZUS scheme
Potential reform directions

Accomodating self-employed and farmers in general pension systems, but:

- simplified administrative procedures
- rules for setting contribution rates and contribution bases adjusted to the situation of the self-employed and general economic development
- keeping adequacy of pension benefits
- defined-contribution environment better accommodates different employment patterns
Current situation
State of the pension system in 2018

**NDC holds, its construction allows to maintain long-term balance**

**The FDC:**
- Gradually declining assets due to the slider mechanisms
- Lack of belief that the funds will hold

**Further changes:**
- Reversing the raising retirement age to 67 for men and women: back to 60/65, high risk of minimum pensions for women
- Pension indexation: partially lump-sum
- Minimum pension raised to 1000 PLN per month in 2017, strengthening the poverty protection role

**Boosting savings: Proposal of Employee Capital Accounts from 2019**
- Automatic enrollment
- Mandatory for all employers
- Additional contribution with the state copayment

- Initial payment from the state budget :PLN 250 plus annual co-payment PLN 240
- Contributions from employers: 1.5% (basic) + 2.5% (additional)
- Contribution from employees: 2.0% (basic) + 2.0% (additional)

- Asset managers: investment funds
- Payouts: lump-sum or 10-year scheduled withdrawal
Long-term trends

INSURED AND PENSIONERS

PENSION EXPENDITURE
Inflow of new pensioners to old-age

Early retirement due to economic restructuring

Constitutional tribunal ruling on early retirement for men

Pension age reached by „reform cohorts“
Average pension level (% of average wage)
Emerging challenge: coverage

MEN

WOMEN
Adequacy - PAR

<table>
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<tr>
<th>TRR case</th>
<th>Net (%)</th>
<th>Gross (%)</th>
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<tr>
<td></td>
<td>2016</td>
<td>2056</td>
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<tr>
<td></td>
<td>Men</td>
<td>Women</td>
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<tr>
<td>Variant: old base case: 40 years up to 65</td>
<td>82.4</td>
<td>86.1</td>
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<td>75.6</td>
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<td>New base case: 40 years up to the SPA</td>
<td>85.9</td>
<td>73.0</td>
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<td>63.8</td>
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<td>38.2</td>
<td>32.1</td>
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<td>Increased SPA: from age 25 to SPA</td>
<td>85.9</td>
<td>65.9</td>
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<td>AWG career length case</td>
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<td>Longer career: 42 years to SPA</td>
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<td>Shorter career: 38 years to SPA</td>
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<td>Deferred exit: 42 years to SPA +2</td>
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Implicit pension debt

- For the first time the estimates of pension liabilities were published by the Central Statistical Office, according to new requirements of public statistics.

- At the end of 2015 the total liabilities amounted to 4960 billion PLN (276% of GDP), of which:
  - 4100 billion: NDC accounts
  - 325 billion: farmers
  - 392 billion: armed forces
  - 140 billion: open pension funds
LESSONS LEARNT
Lessons learnt

➢ Reforming pensions requires:
  o Concept
  o Legislation
  o Administration

➢ Pension reform is a long-term process
  o Launch of the change is just the beginning
  o Ensuring long-term support requires constant activity
  o Things can divert significantly from the initial plan

➢ Pension system is an important item in the political agenda

➢ Retirement age is a noticeable point in these discussions

➢ Short-term gains can be more valued than long-term stability or adequacy (lower retirement age of women)

➢ Coverage: undiscovered risk