The pension system in Poland
From mid 1990s until today

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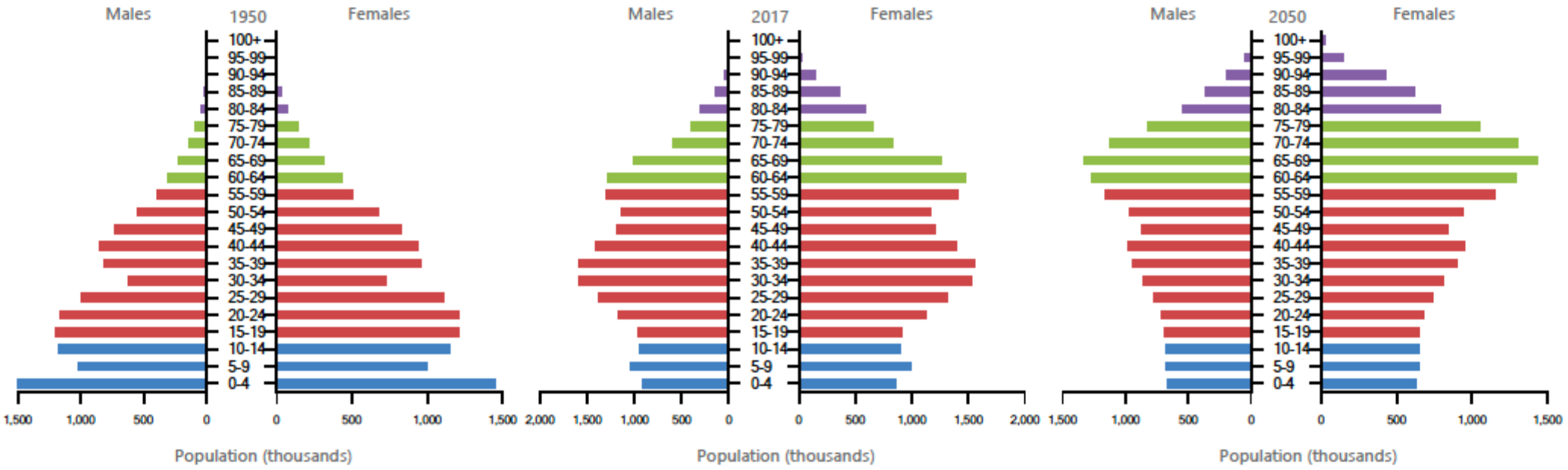
Outline

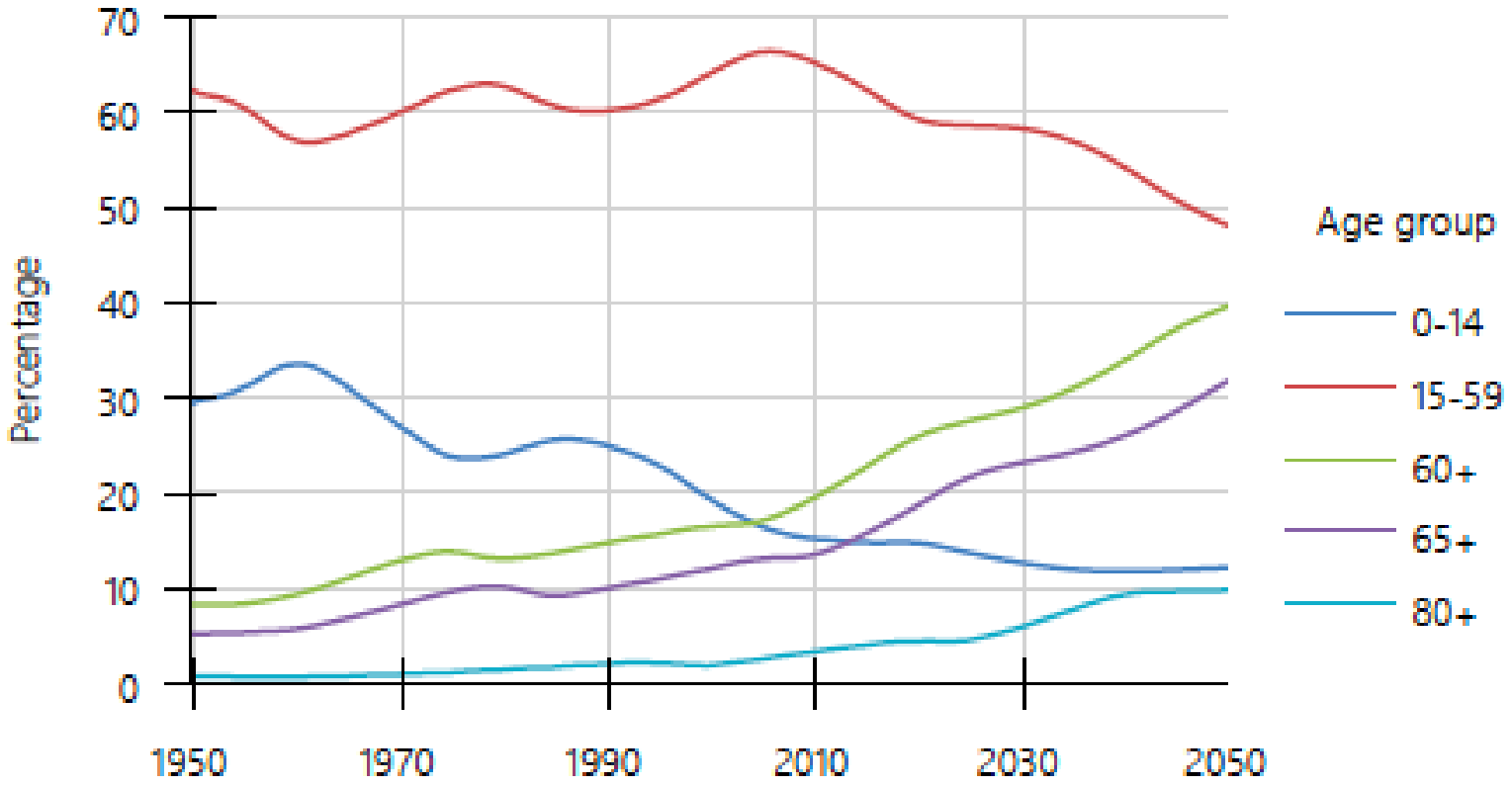
1. Context: 25 years of economic transition in Poland
2. Evolution of the employees' pension system in Poland in the past 25 years
3. Farmers' pension system developments and challenges
4. What next?
5. Lessons learnt

Zmiany struktury wieku ludności Polski w perspektywie wieku



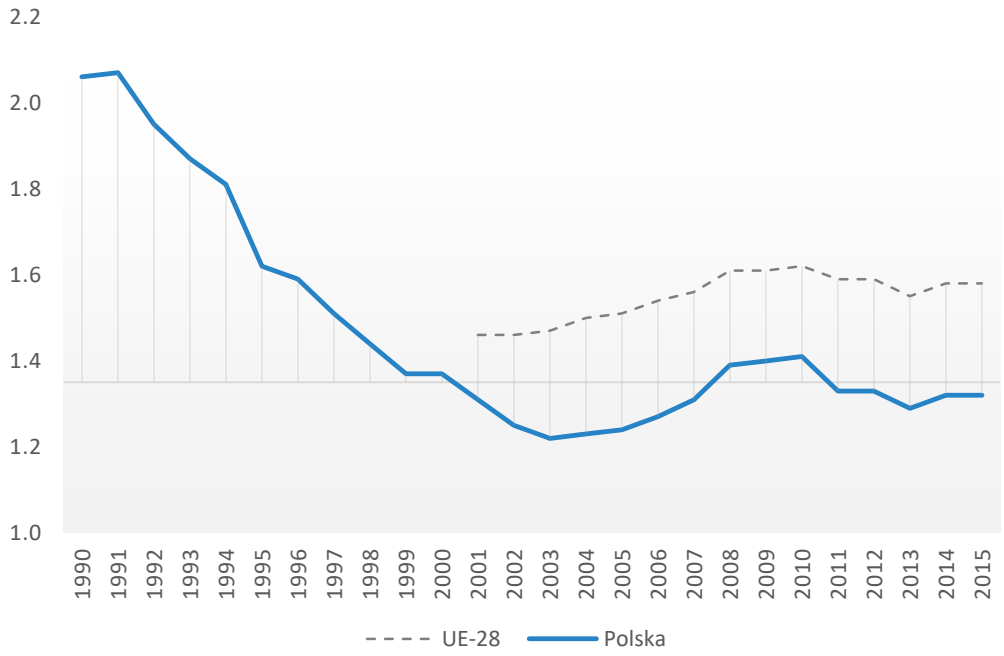
https://population.un.org/ProfilesOfAgeing2017/index.html

Changes in the age structure of the Polish population

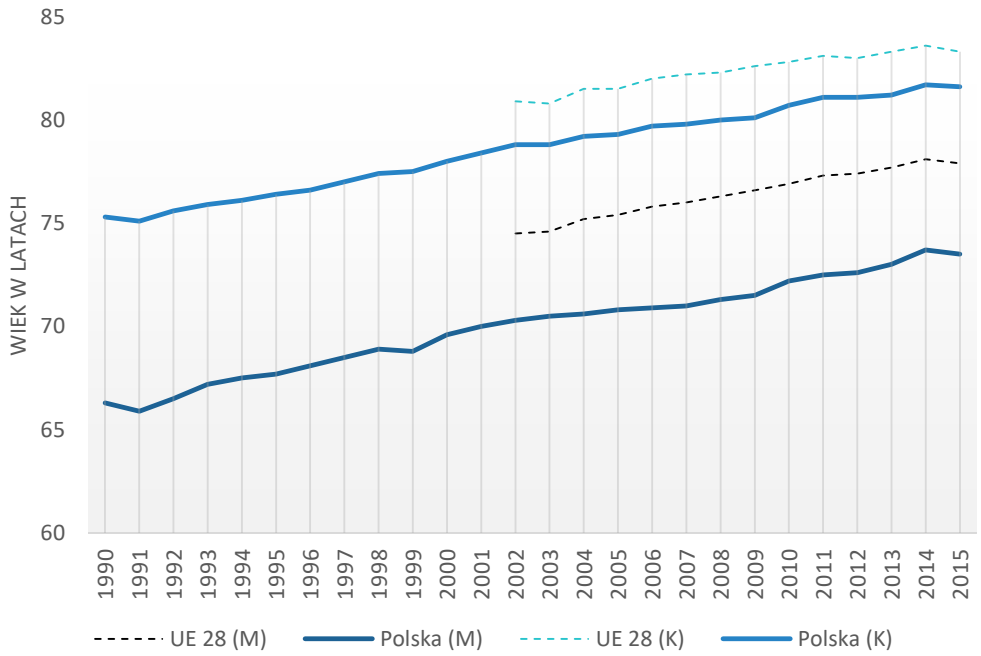


Fertility remains low and life expectancy increases

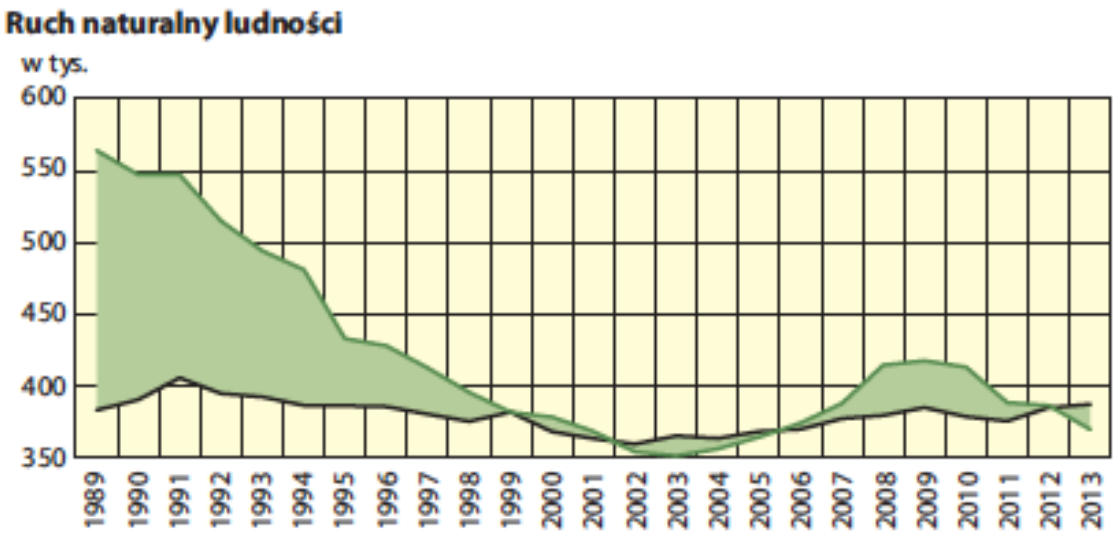
FERTILITY RATE: PL VS EU



LIFE EXPACTANCY: PL VS EU



Population ageing



FIRST SIGNS OF POPULATION AGEING

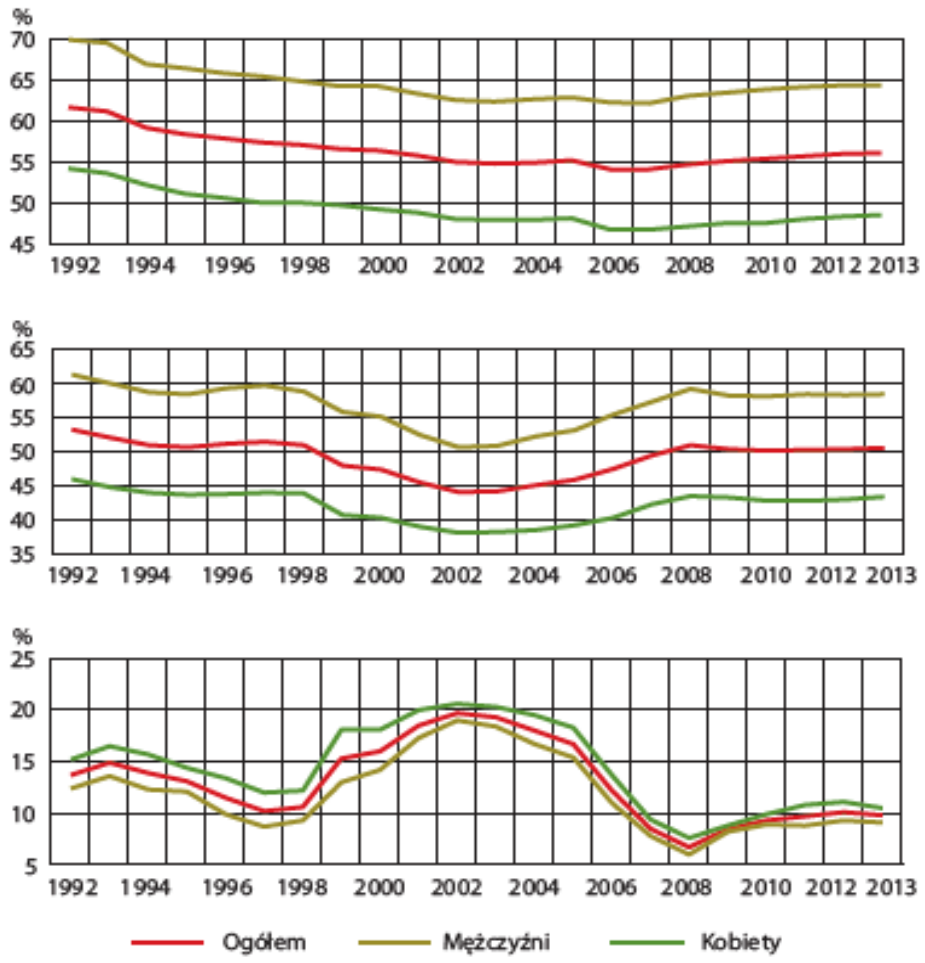
Changing age structure of the population

Falling fertility and lower number of births

Extening life expectancy

Population growth close to zero

Labour market

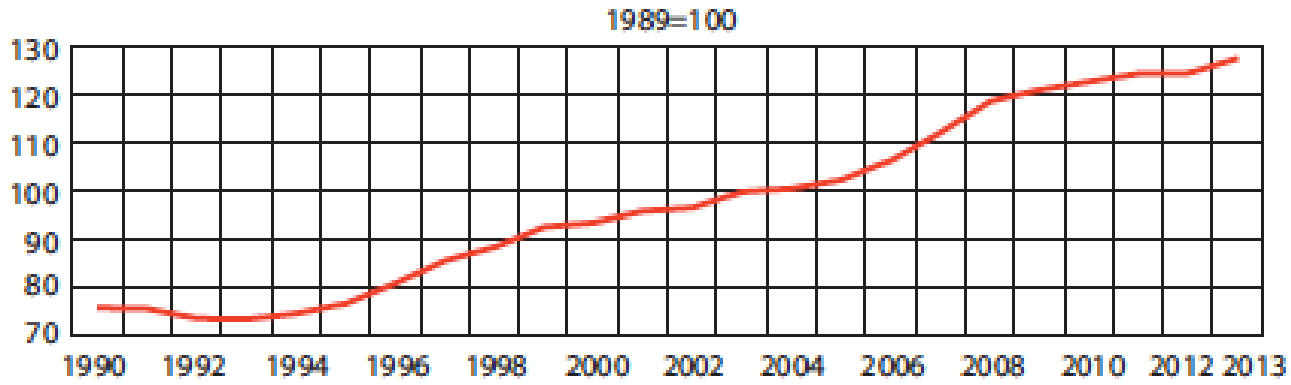


Economic activity(15+)

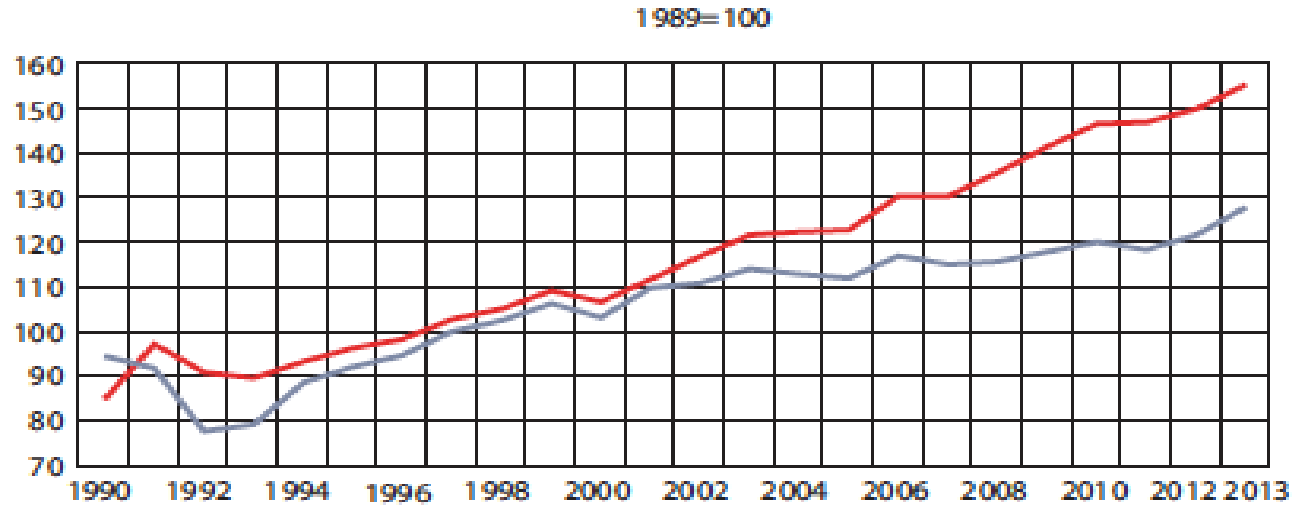
Employment ratio (15+)

Unemployment rate (15-74)

Levels of income



INDEX OF REAL GROSS SALARIES

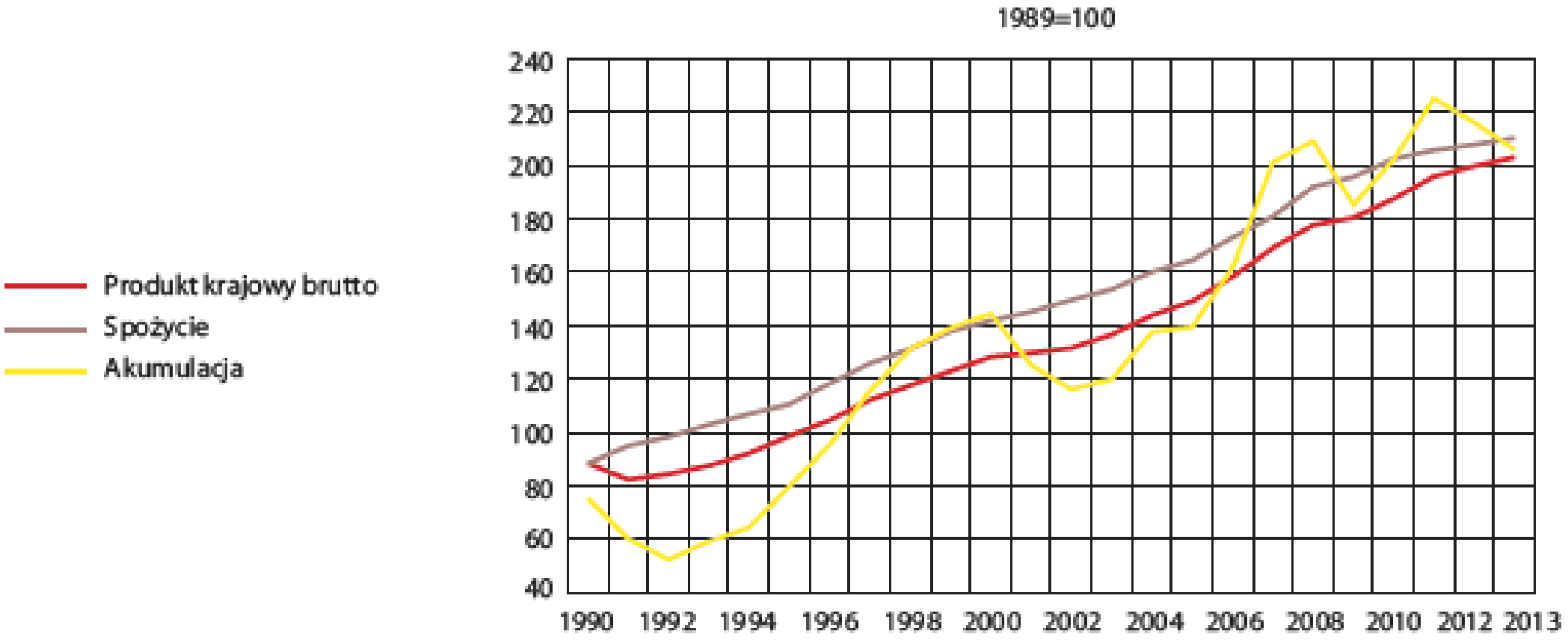


INDEX OF REAL GROSS PENSIONS

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

Pension system after economic transition

Pension system in early 1990s: restoring adequacy

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 in early 1990s: restoring adequacy

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

Shaping the pension reform in Poland – „Security through diversity”

Shaping the pension reform in Poland – „Security through diversity”

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

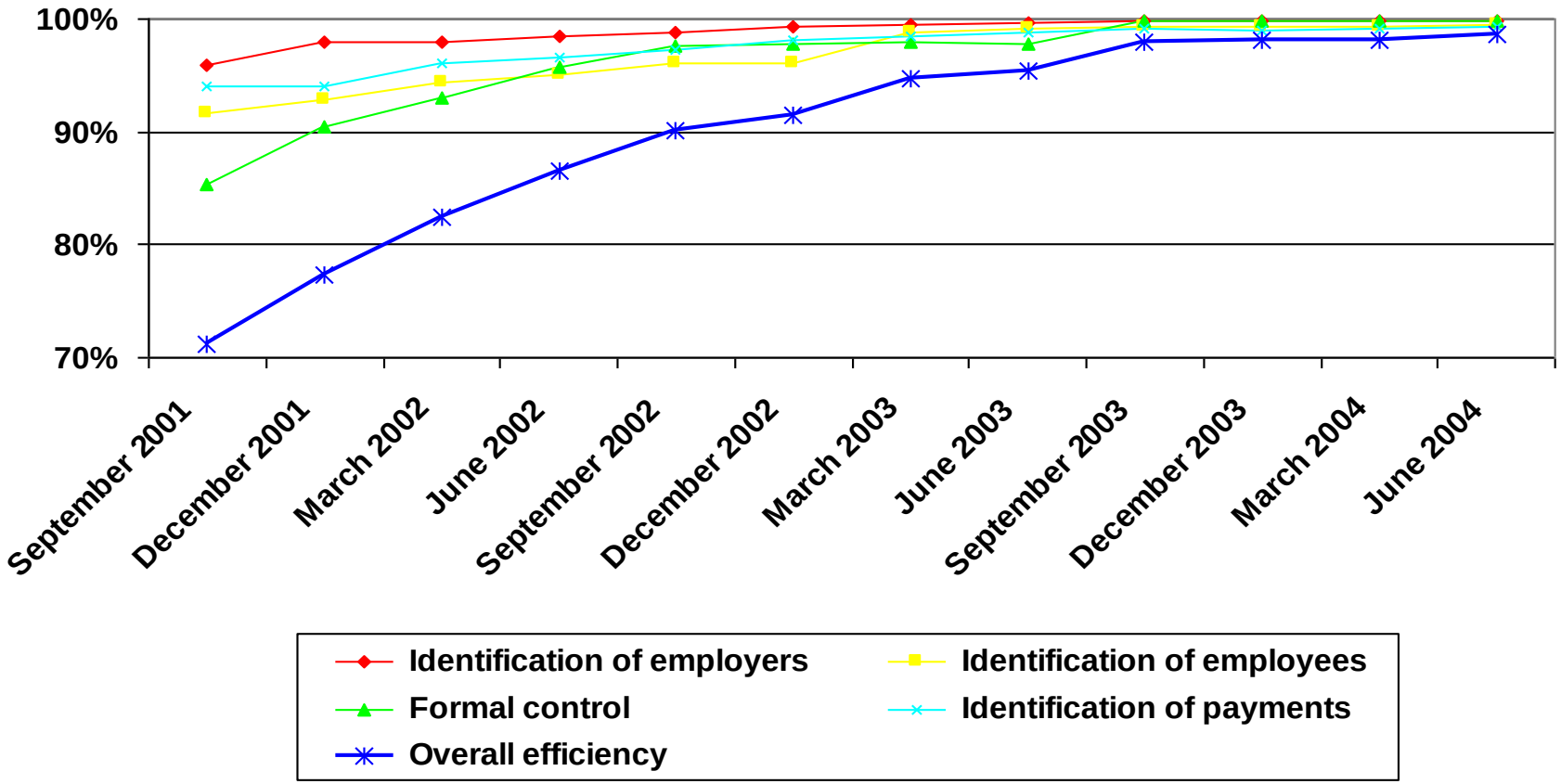
- Introduction of the new IT system with delays
- Errors in individual contribution records
- Longer calculation of initial capital

- Administration is crucial for the smooth implementation of the pension reform

First tier

ZUS - Correctness of information

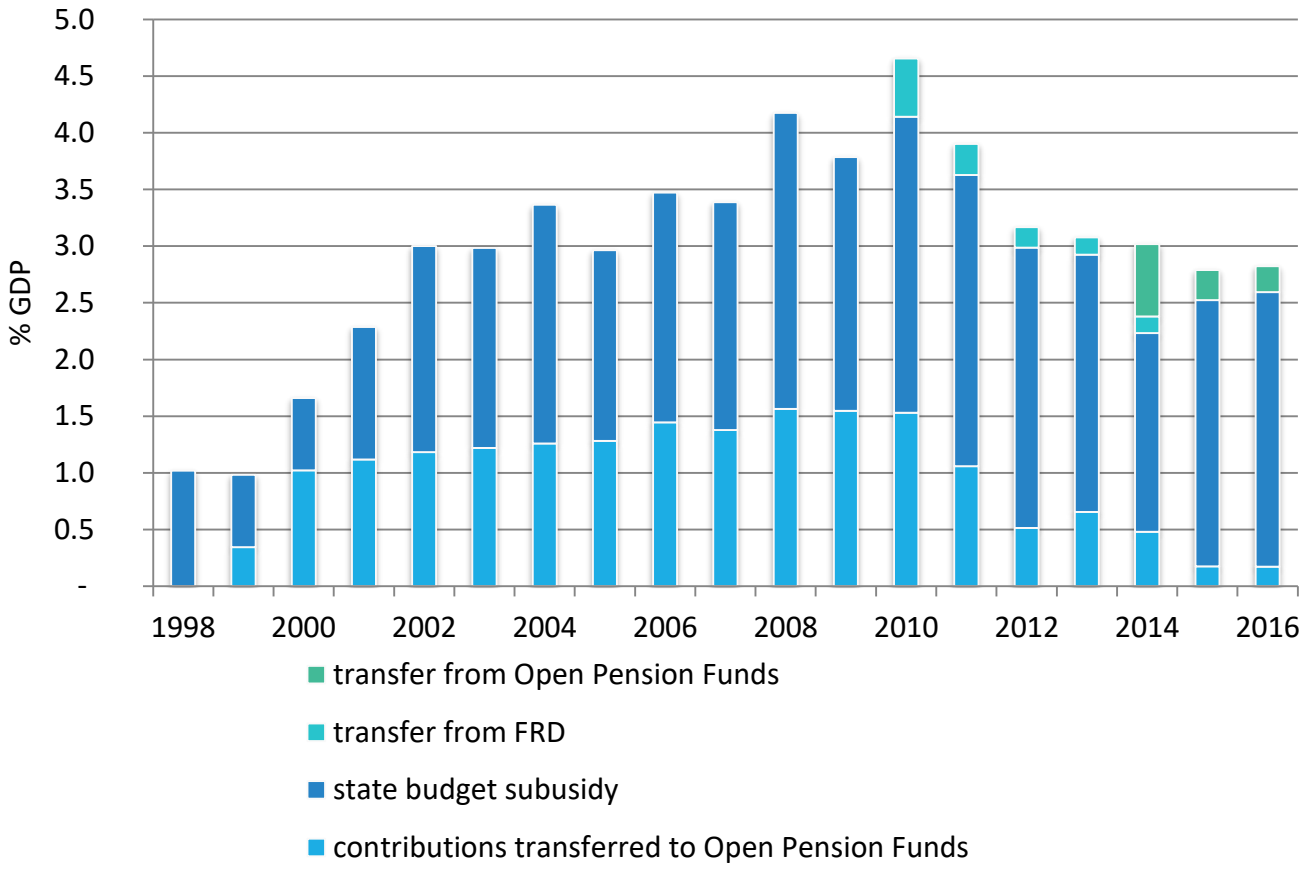
Shaping the pension reform in Poland – „Security through diversity”



Source: ZUS

Financing of the pension system

15+ years of reform implementation



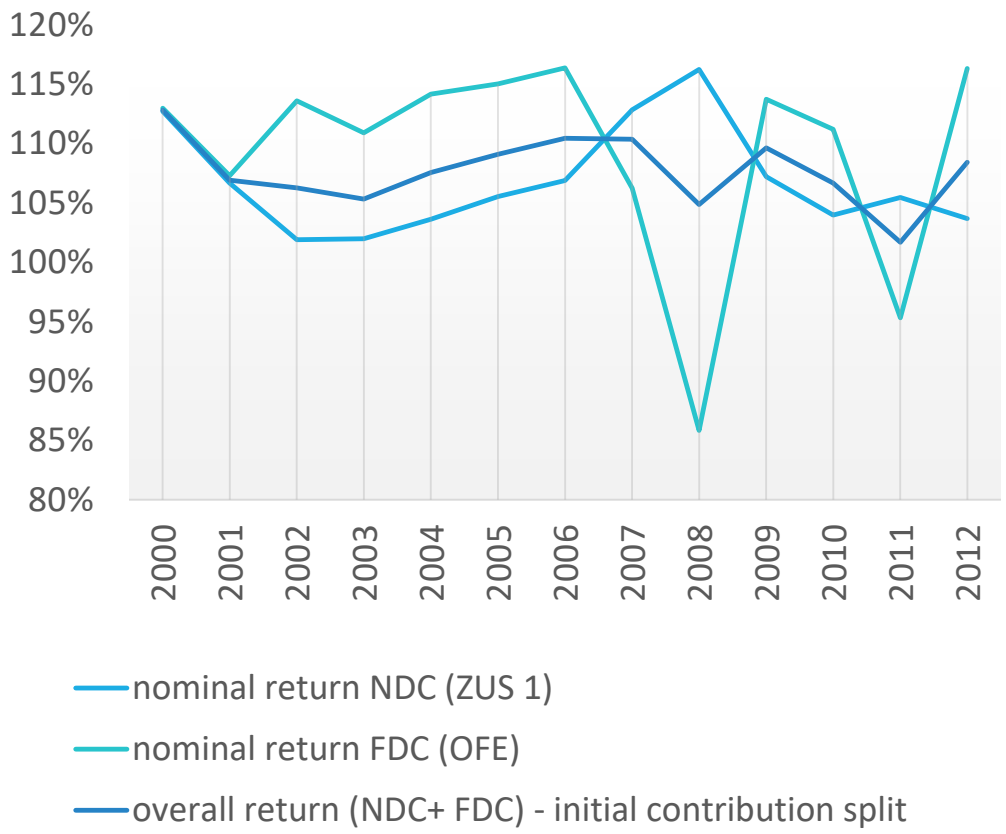
Initial administrative problems causing arrears in contributions tranfers to FDC

High pension system deficit adding to transition costs

- Postponed withdrawal of early retirement
- More generous pension indexation
- Falling contribution revenue

Returns on individual accounts

15+ years of reform implementation



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

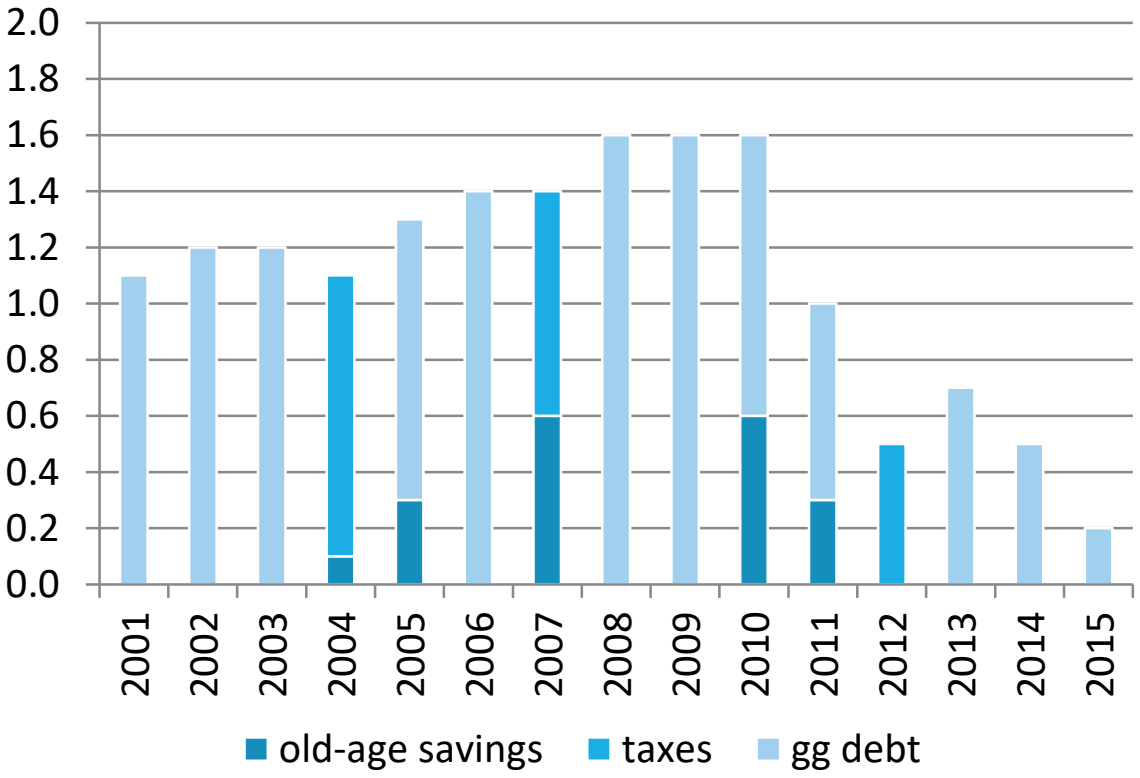
Expectations and facts about financing transition costs

15+ years of reform implementation

Expected privatization revenues were used also for other purposes

Postponed savings in PAYG part

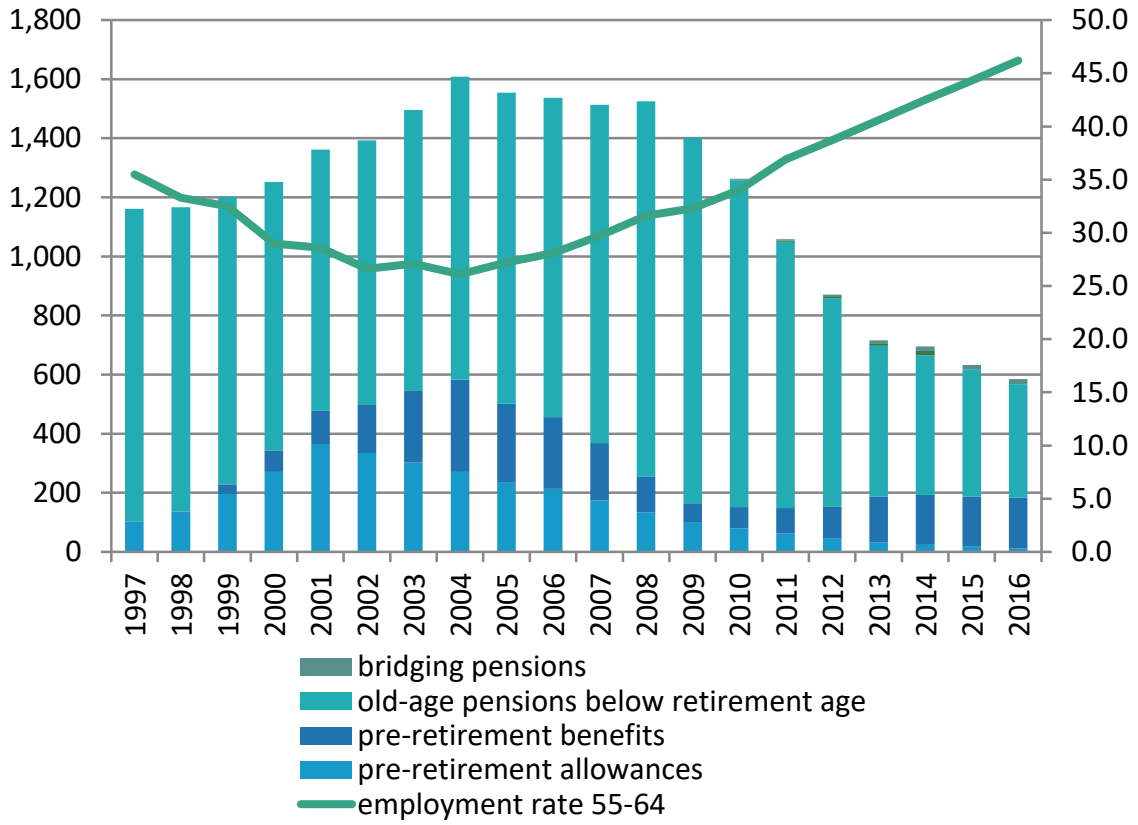
Relaxed fiscal policy reduced room to finance transition cost, especially after 2008 economic slowdown



Early retirement struggle

15+ years of reform implementation

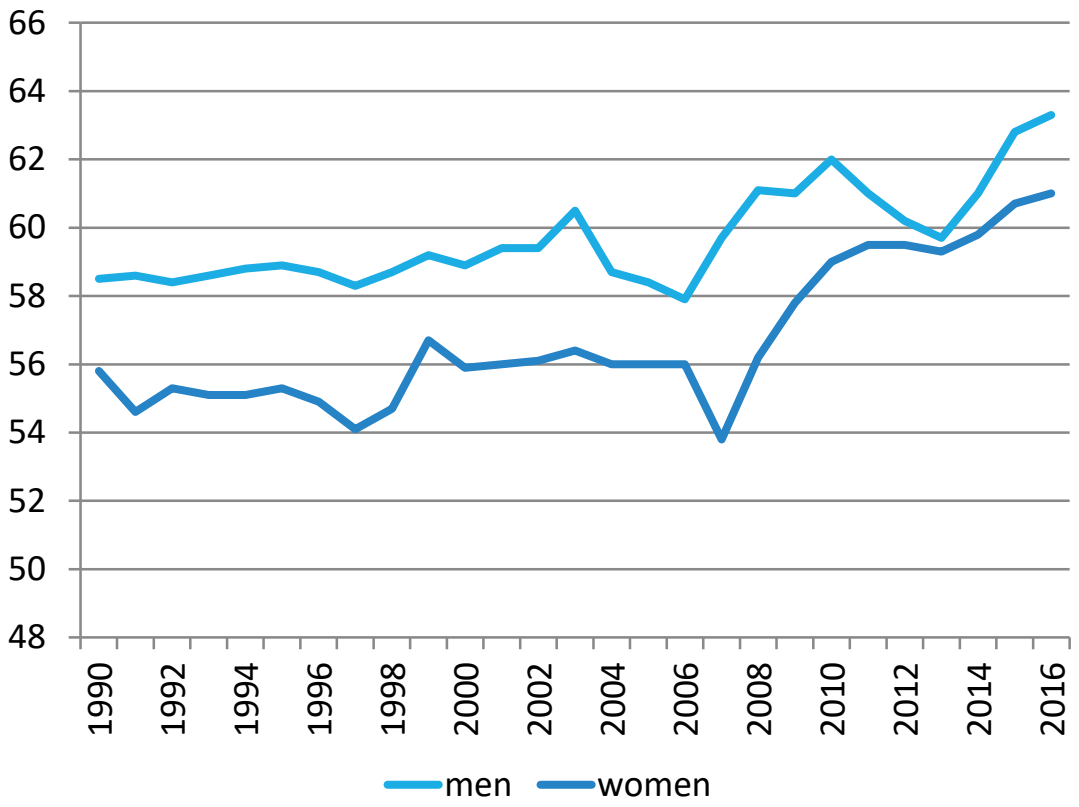
- The reform plan was to reduce early retirement
- During first years: early retirement expanded through pre-retirement transfers
- Possibility of early retirement extended from the end of 2006 till the end of 2008
- The final plan of „bridging pensions" introduced from 2009
- Quick reduction of early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



Retirement age

15+ years of reform implementation

- Traditionally different retirment age of men and women: 65 and 60
- Initial reform prop2013osal 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 retirment age reversed: estimated inflow of new retirees: 417 thousand people, including 312 thoustand after October



The new pension system in Poland: implementation ex

15+ years of reform implementation

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 partcially 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, additonal 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

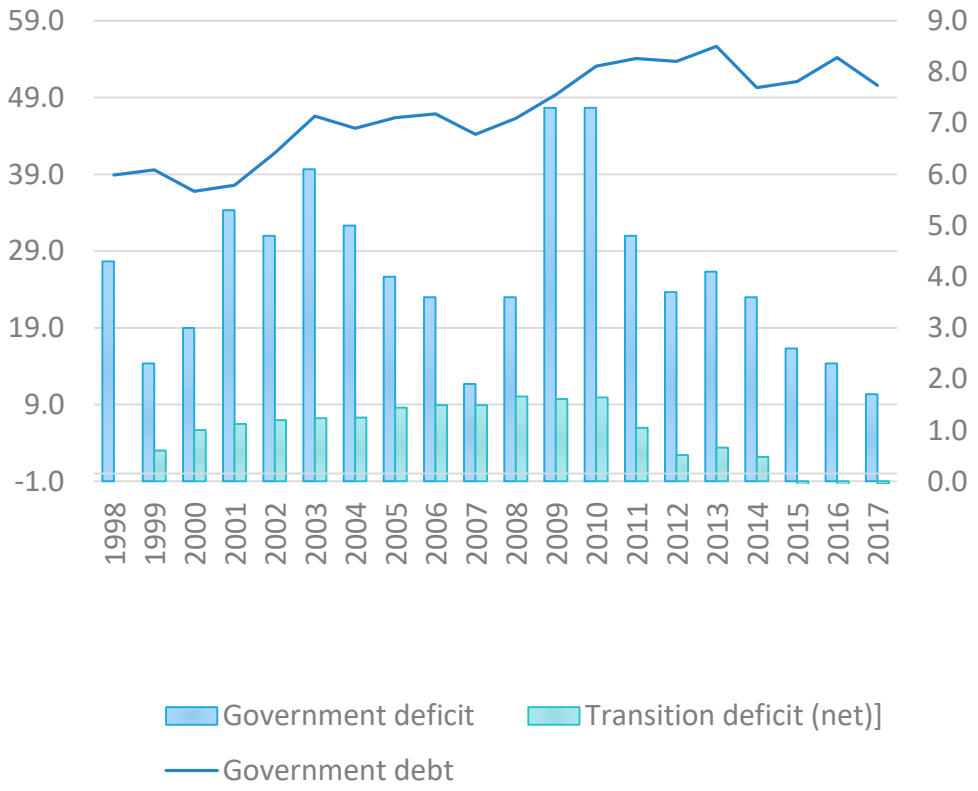
Pension system after economic and fiscal crisis

May 2011:

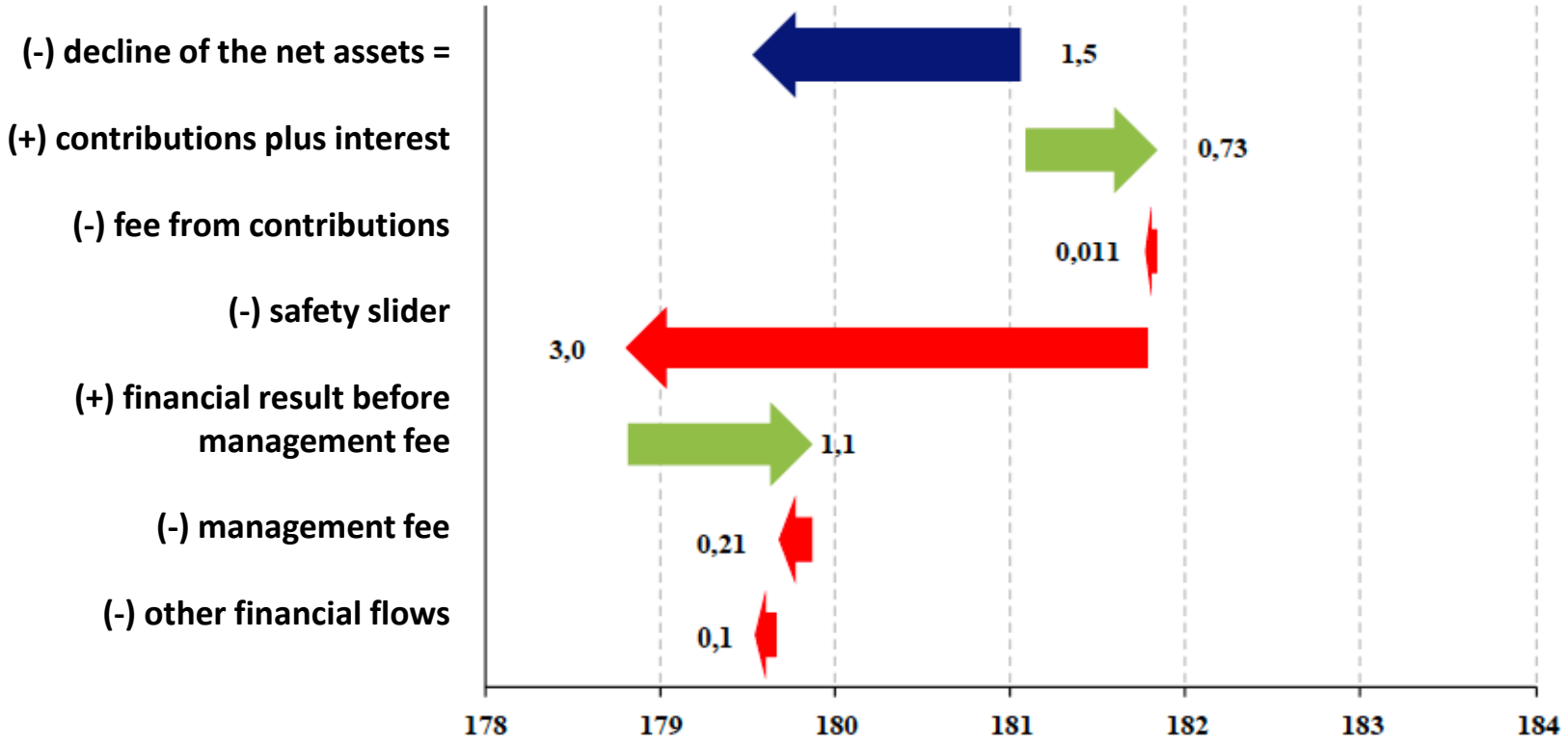
- Contribution rate to FDC reduced to 2.3% in May 2011
- 5% of wage recorded on quasi-NDC account (indexed to GDP growth)

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

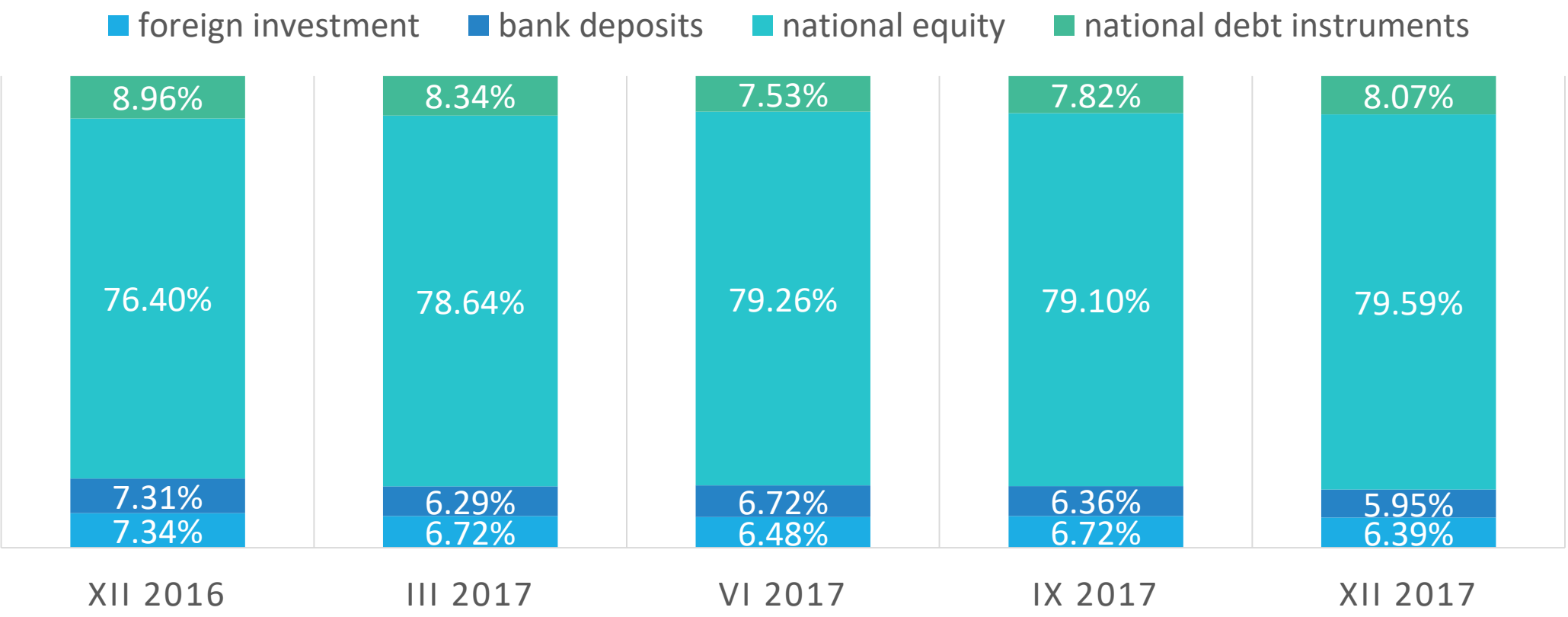


Decomposition fo the changes of pension funds' assets (bln PLN)



Source: Financial Supervision Committee

Structure of the investment portfolio



Conseqences of the reversal

Pension system after economic and fiscal crisis

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 sigificantly

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 involvment of pension funds on the primary market

Sustainability and adequacy of pension system as of today

Pension system after economic and fiscal crisis

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

Pension system after economic and fiscal crisis

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

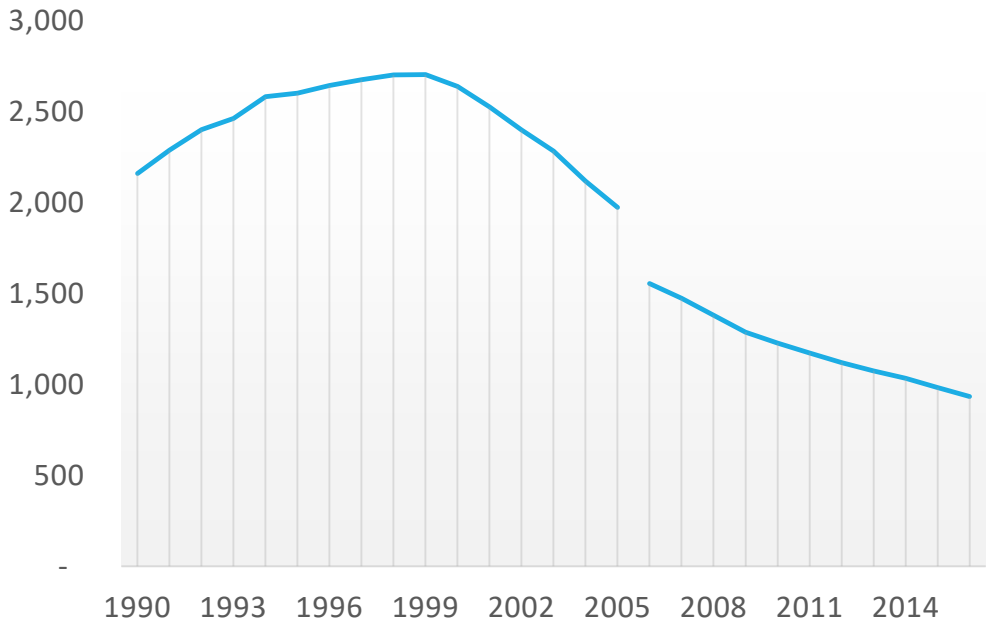
1999 changes in disability legislation

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

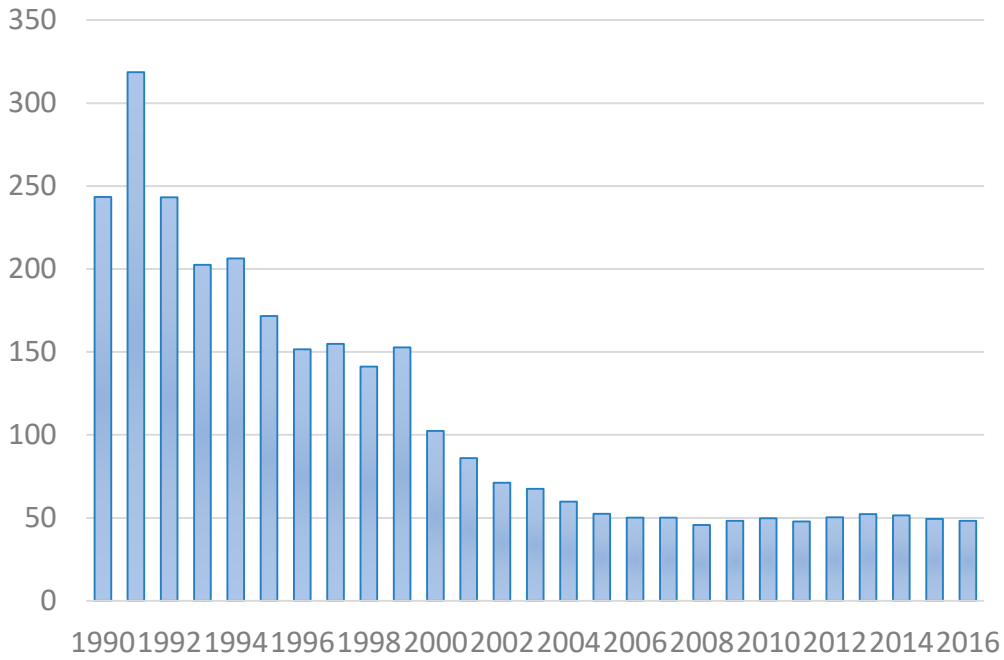
- Change in the disability assessment
  - Developing network of assessment doctors employed in the Social Insurance Institution
  - Moving away from assessment by doctors' committees

Disability pensions – reverse of trend after 1998 change of legislation

NUMBER OF DISABILITY PENSIONS PAID



NUMBER OF NEW DISABILITY PENSIONS GRANTED



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

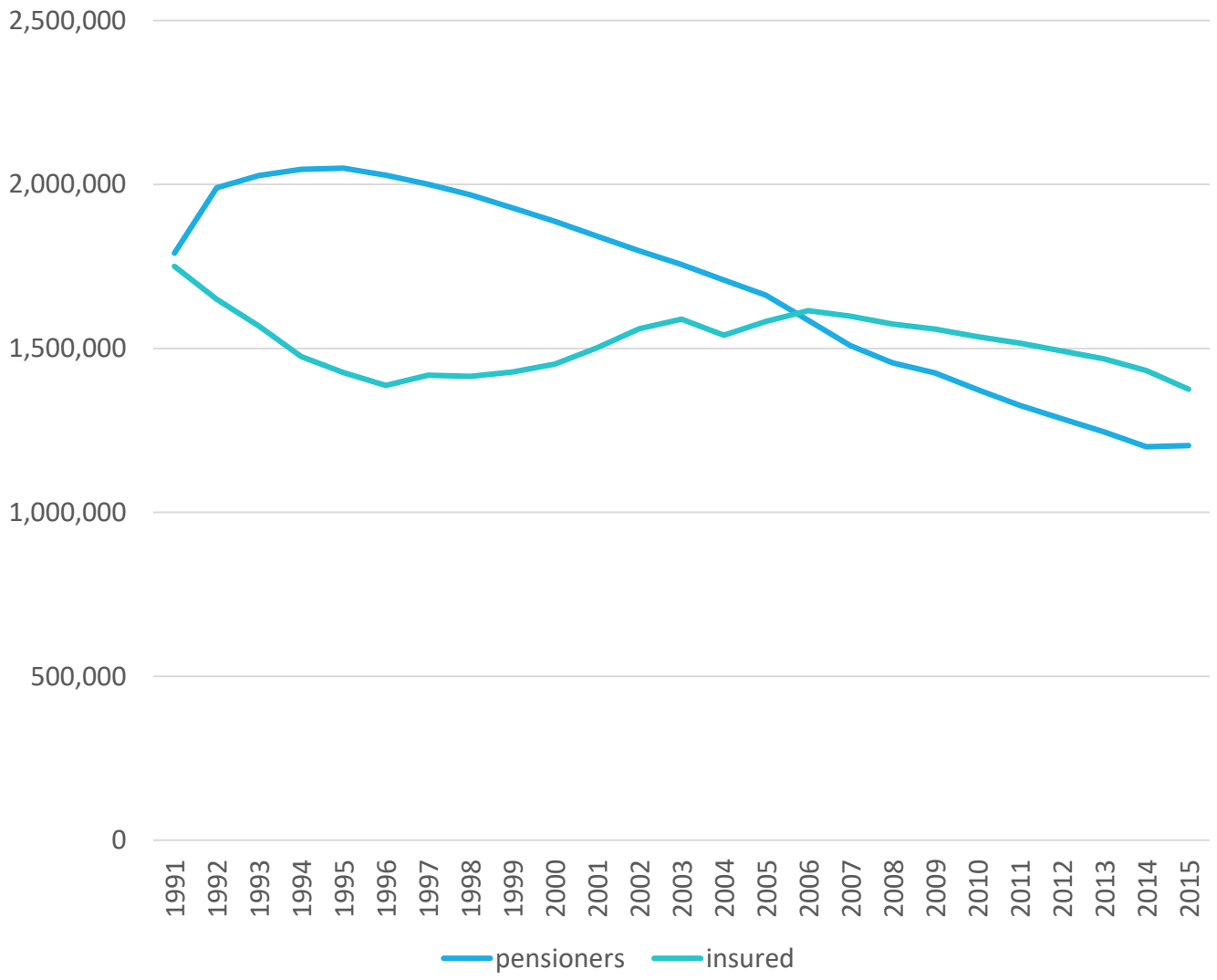
- Heavy role of subsidies from the state budget
- Initially 70 per cent of expenditure, but then increasing to more than 90% of expenditure, due to inflation reason
- Flat-rate contributions and benefits
  - Contributions more than 8 times lower than for self-employed outside agriculture
  - Benefits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

KRUS – insured and pensioners

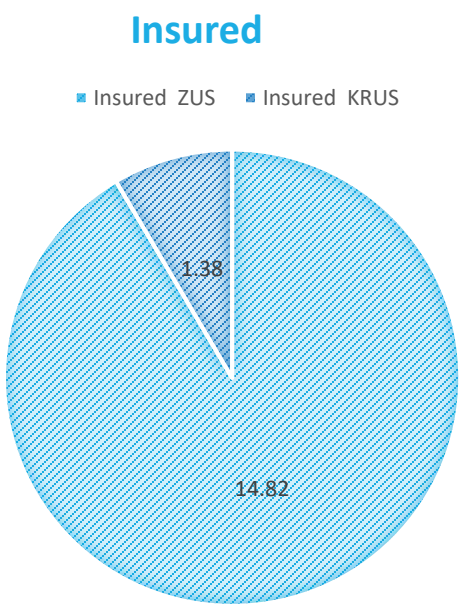
Number of pensioners was larger than insured until mid-2000s

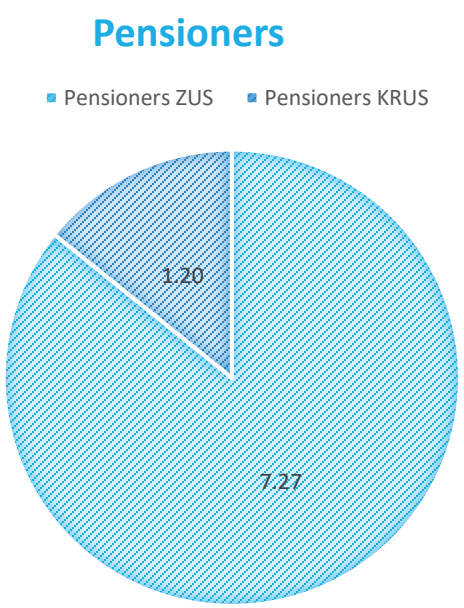
Share of farmers in the employment declines leading to lower number of insured and also pensioners

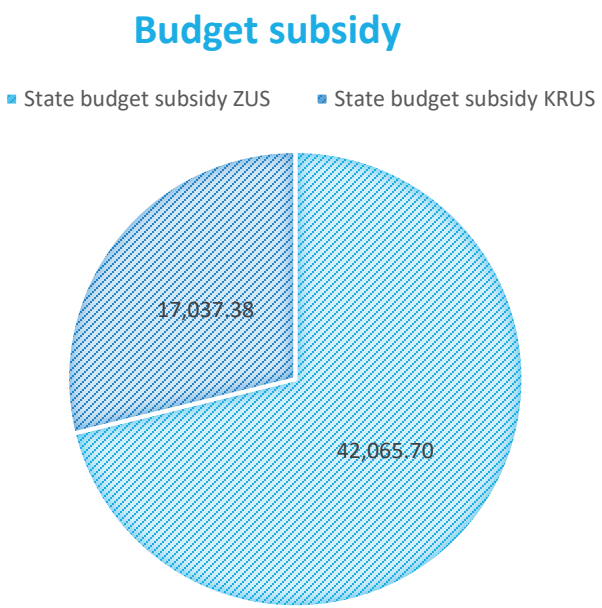
Increase in the nubmer of insured due to legal changes: acces to KRUS insurance for smaller farmers



ZUS and KRUS in Poland, 2015







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 accomodates 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, strenghtening 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

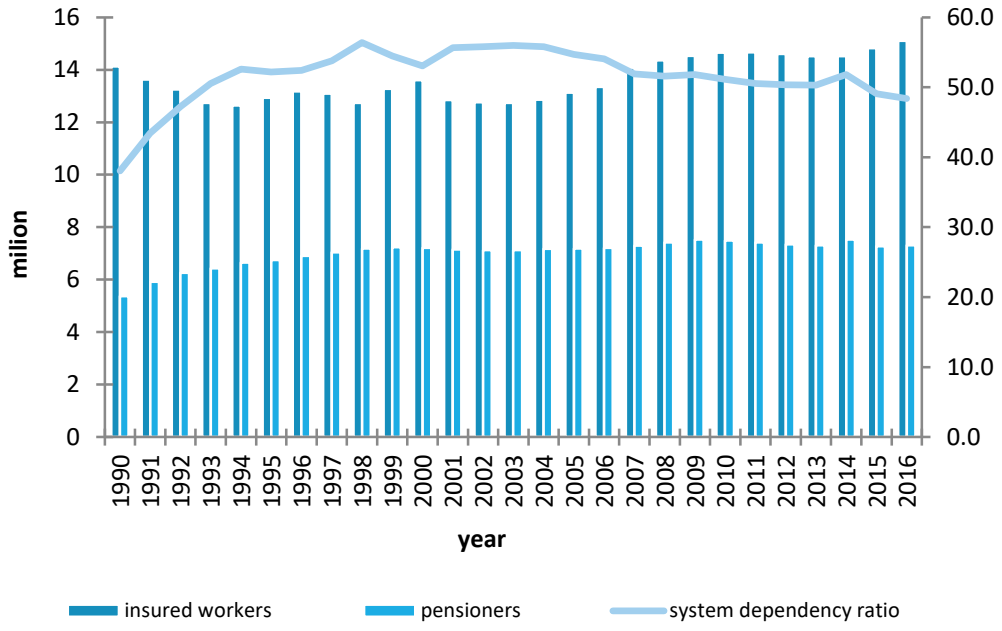
- Initial payment from the state budget :PLN 250 plus annual co-payment PLN 240
- Contributions from employers: 1.5% (basic) + 2.5% (additional)
- Contribution from employees: 2.0% (basic) + 2.0% (additional)

- Asset managers: investment funds

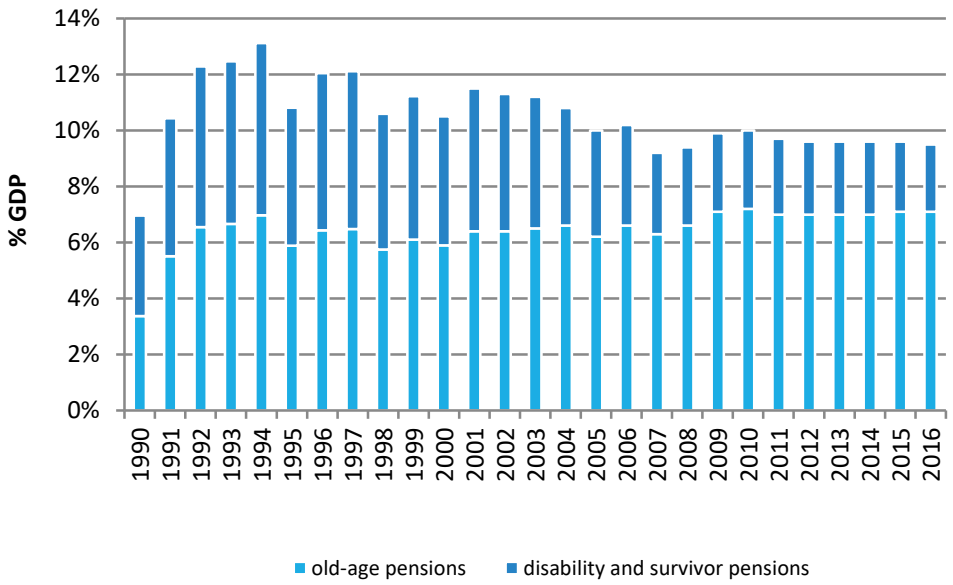
- Payouts: lump-sum or 10-year scheduled withdrawal

Long-term trends

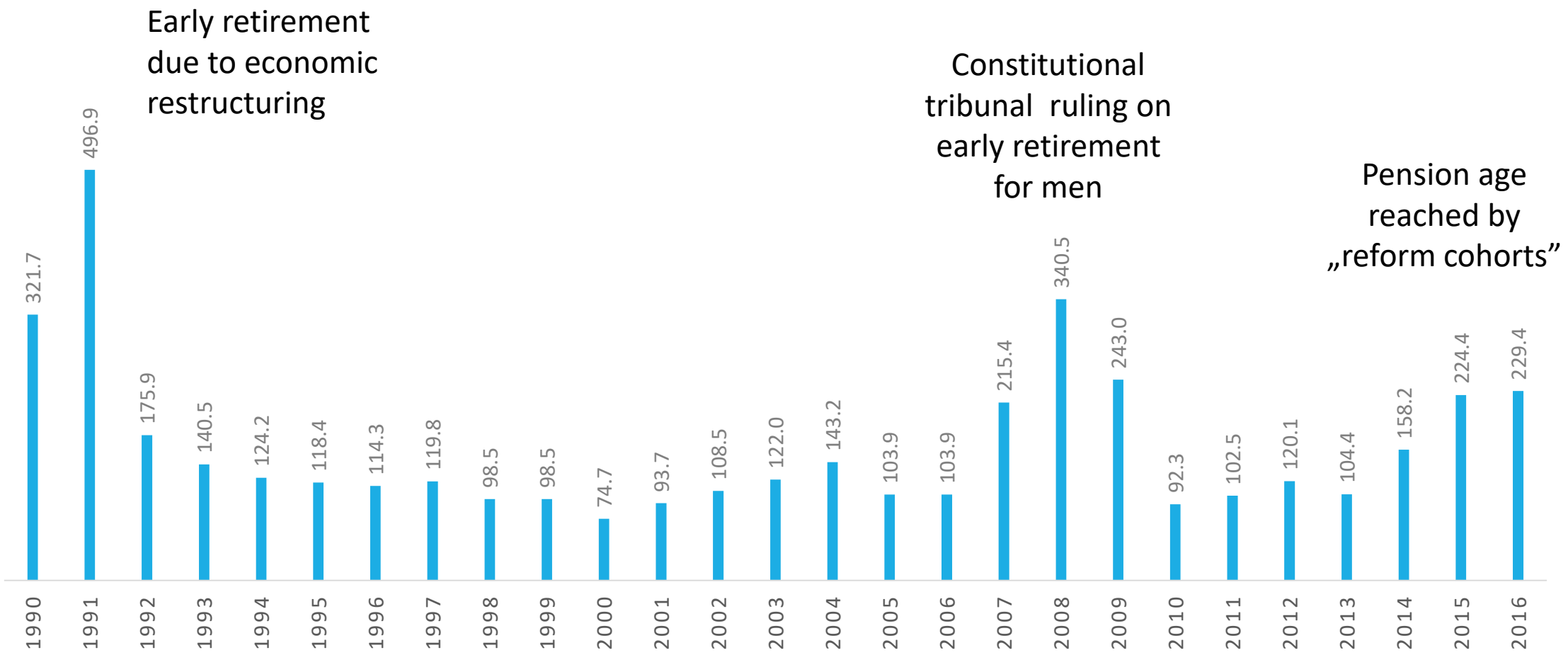
INSURED AND PENSIONERS



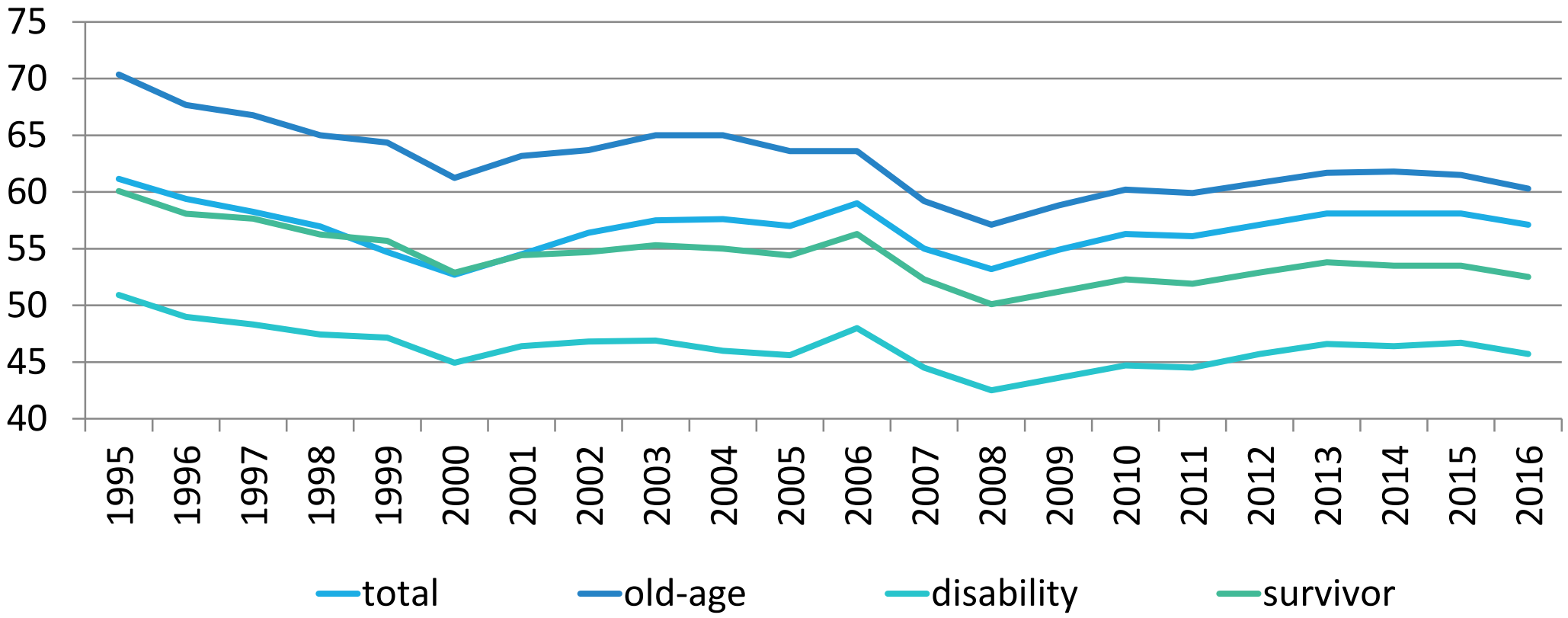
PENSION EXPENDIUTRE



Inflow of new pensioners to old-age



Average pension level (% of average wage)



Emerging challenge: coverage

MEN

WOMEN

Adequacy - PAR

TRR case		Net (%)				Gross (%)			
		2016		**2056**		**2016**		**2056**	
		Men	Women	Men	Women	Men	Women	Men	Women
Average Earnings	Variant: old base case: 40 years up to 65	82.4	86.1	44.7		72.2	75.6	38.2	
	New base case: 40 years up to the SPA	85.9	73.0	44.7	37.8	75.4	63.8	38.2	32.1
	Increased SPA: from age 25 to SPA	85.9	65.9	44.7	32.9	75.4	57.5	38.2	27.8
	AWG career length case	85.1	70.7	45.8	36.4	74.7	61.7	39.2	30.9
	Longer career: 42 years to SPA			47.0				40.3	
	Shorter career: 38 years to SPA			42.4				36.2	
	Deferred exit: 42 years to SPA +2			49.9				42.8	

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 bilion: NDC accounts
  - 325 bilion: farmers
  - 392 bilion: armed forces
  - 140 billlion: open pension funds

LESSONS LEARNT

Lessons learnt

- Reforming pensions requires:
  - Concept
  - Legislation
  - Administration
- Pension reform is a long-term process
  - Launch of the change is just the beginning
  - Ensuring long-term support requires constant activity
  - 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