



# SOCIAL DEVELOPMENT NOTES

ENVIRONMENTALLY AND SOCIALLY SUSTAINABLE DEVELOPMENT NETWORK



The Participation and Civic Engagement Team works to promote poverty reduction and sustainable development by empowering the poor to set their own priorities, control resources and influence the government, market and civil society institutions; and influencing governmental and private institutions to be responsive, inclusive, and accountable.

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## Case Study 4 – Poland: Participation in Macroeconomic Policy Making and Reform

### Poland: Pension Reform

#### Background

In January 1999, Poland launched a new pension system that was the result of 5-6 years of broad outreach campaigns and complex negotiations within the government and between the government and key stakeholder groups. A number of compromises were made to broaden support for the reform; these changes will significantly increase costs during the transition period but without undermining the long-term viability of the reformed pension system.

Post-communist Poland operated on a traditional pay-as-you-go (PAYG) system; payroll taxes of current workers financed the pension benefits of current retirees. Due to a number of policy changes expanding early retirement options and other privileges, pension costs skyrocketed in the mid-1990s and Poland had one of the highest spending rates of any post-communist transition country. In addition, long-term demographic shifts led to a decline in people paying into the system relative to those receiving benefits. Contribution rates (i.e.,

payroll taxes) had already risen from 25% in 1981 to 45% in 1990. They could not easily be pushed up further.

The ongoing debate on pension reform quickly spread from experts to policymakers as pension spending increased from 8.6% of GDP in 1990 to 15.5% in 1994. Fiscal conservatives pushed successfully to limit deficit spending. Through a series of *ad hoc* measures, policymakers began to chip away at pension benefits in an effort to close the gap between contributions and benefits.<sup>1</sup> This got the government through the immediate fiscal crisis but it provoked strong criticism from pensioners and unions and may have contributed to the eventual collapse of the post-Solidarity government in 1993.

<sup>1</sup> Steps included reversal of benefits for special groups, such as those undertaking hazardous jobs, under-indexing so that benefits lagged behind rising prices, changes in tax treatment of pension benefits, changes in the wage base for calculating pensions and a reduction in minimum guaranteed benefits.

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The new government, led by the Democratic Left Alliance (SLD), came into office promising “fair” benefits for pensioners but faced an even worse situation. Constitutional Tribunal rulings had found the *ad hoc* changes illegal and ordered the government to restore lost benefits to pensioners. These rulings promoted the view that the government had effectively “defaulted” on its obligations, undermining public confidence in the system as a whole. Demographic trends continued downward.<sup>2</sup> By 1994, the proponents of comprehensive reform were gaining ground.

**Key Stakeholders: Pension Reform in Poland**

- Alliance of the Democratic Left (SLD) government 1993-97 (left-centrist)
- Solidarity Electoral Action government 1997-present (right-centrist)
- Trade unions, including “old” OPZZ and “new” - Solidarity federations
- Pensioners and workers nearing retirement (close to 50% of eligible voters)
- Middle-aged and young workers paying into the system
- Social Insurance Institution (ZUS) with 4,000/40,000 employees

**Process**

*Building Consensus within the Government*

The new government began to assess its options. Several countries facing demographic pressures had switched from a PAYG system to a “funded system”. Under a funded system, each generation effectively pays for itself. Contributions accumulate and are invested on behalf of each worker by privately operated pension funds. The amount of the pension varies with the performance of the fund but with a minimum return typically guaranteed by the government or the fund. Funded systems do not rely on intergenerational transfer and, in this way, address the demographics problem. But the shift from a PAYG system to a funded system imposes high transition costs; new workers no longer finance current retirees and the government must step in to fill the gap. In many cases, countries move to a “multi-pillar system” that combines a PAYG pillar with one or more funded pillars.

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<sup>2</sup> One study estimated that, by 2050, the number of pensioners would double and the number of working-age people would fall by one quarter.

The Ministry of Labor (MOL) wanted to modify and retain the current PAYG system. The Ministry of Finance (MOF) wanted to convert to a predominantly funded system. Two civil society actors, the Solidarity movement and the Institute of Labor and Social Policy, formulated proposals that fell between these two poles. These received far less attention but indicated involvement by actors outside the government early in the policy reform process. The Institute also hosted an expert conference to discuss the four proposals.

Disagreements between the two ministries and within the SLD effectively stalled reform for the next eighteen months. The Minister of Labor, a party heavyweight, initially had the upper hand and his proposal went out for public consultation in May 1995. The MOF insisted that its proposal be included by way of contrast. Polls indicated that the public had doubts about the solvency of the current system, found the MOL’s proposal too timid and wanted more serious reform. In the autumn of 1995, Parliament approved a broad program prepared by the Deputy Prime Minister and Finance Minister that included a mandatory funded pension. The MOL shifted to delaying tactics.

In February 1996, following a cabinet reshuffling and appointment of a new Prime Minister, the reformers finally got a clear upper hand. Both the new Prime Minister and his new Labor Minister now supported fundamental reform.

*Building Coalitions across Parties*

The new Labor Minister, Andrzej Baczkowski, was a skilled negotiator and, since 1994, had been chairman of the tripartite commission of government, labor and business. He was a former Solidarity activist, and thus provided a bridge to a key opposition force. He was named to the newly-created post of Plenipotentiary for Pension Reform and a special Office for Pension Reform (OPR), led by a Polish official from the World Bank, was created outside the Ministry of Labor to lead technical efforts.<sup>3</sup> These two steps helped greatly to improve inter-agency coordination, signal government commitment, and draw in external expertise.

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<sup>3</sup> Both the World Bank and USAID helped to finance activities of the Plenipotentiary and the Office for Pension Reform.

Baczkowski built a team of experts and began working quietly on a significantly revised program but calling it an update and expansion of the previous proposal that was viewed as too conservative. In doing so, he incorporated two elements of the Solidarity proposal, the addition of a funded pillar to the PAYG pillar and the use of privatization funds to finance the pension system. Meanwhile, in light of continued protests from pensioners, he worked effectively to pass legislation changing the rules on indexing of pensions to address immediate concerns.

The revised program, entitled “Security through Diversity”, was completed in February 1997, three months after Baczkowski’s sudden death. The program called for a three-pillar system: a reformed PAYG pillar (mandatory for workers over 50), a new funded pillar (mandatory for workers under 30), and a third voluntary funded pillar for supplemental funded plans. Workers between 30 and 50 could choose whether to participate in the second pillar or only in the reformed first pillar. Under the new system, rules permitting early retirement for special groups would be eliminated.

This proposal was carefully crafted to address the potential trouble spots for reform. First, it guaranteed existing benefits for pensioners and older workers, thereby greatly reducing their opposition to reform. Second, it gave the existing Social Insurance Institution (ZUS) and its 40,000 employees a substantial, new role -- and stake -- in the reformed system.

Baczkowski’s successor as Minister of Labor was, once again, a skeptic of reform but strong backing from the Prime Minister kept the OPR-led process moving forward up to the September 1997 elections. More importantly, the incoming Solidarity Electoral Action and Freedom Union government embraced the framework with relatively minor adjustments.

This strategic understanding with Solidarity was essential and unique to Poland. Even the more traditional OPZZ union endorsed the addition of a secondary private pillar to the PAYG system. Trade unions are typically among the strongest opponents of pension reform, preferring a traditional system of defined benefits rather than one that links individual benefits to individual contributions. In most contexts, strategies to

involve them as partners would not succeed.<sup>4</sup> Nonetheless, the SLD government effectively recognized this opportunity and built on it.

### *Managing Trade-offs in the Legislative Process*

Significant modifications were made to the original “Security through Diversity” program following consultations within the government and the tripartite commission and before submission to Parliament. These concessions secured the critical support, on a general level, of trade unions and business associations but would make the transition more costly.<sup>5</sup>

As September 1997 elections neared, the SLD-led government focused on passage of the least controversial elements of reform, meanwhile tying Poland to a timeline that would force the next government to complete the legislative framework in 1998 and start implementation in 1999. Between June and August, laws were passed regulating the second and third pillars and approving the use of privatization funds to finance the transition. The second-pillar law provided for the establishment of a pension fund regulatory agency (UNFE) in May 1998 that would begin to license private pensions funds in August 1998. This law created a new set of powerful stakeholders, private pension providers, who would press for completion of reforms. These laws passed Parliament with the support of 90 percent of deputies across the political spectrum; only a few right-wing deputies from the Christian national wing of the Solidarity movement voted against fundamental reform.

Momentum was lost during transition to a new government. Tensions arose between the two coalition partners over the distribution of political posts. Meanwhile, specific groups began to mobilize against reform. The Solidarity government faced pressure from its own trade union base. The influential railway workers pressed to retain their separate pension system. The SLD, now in the opposition, could not turn its back on a process it had launched, but continued to include opponents of reform.

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<sup>4</sup> Some countries exempt key unions (Mexico) or give them responsibilities. Both the Solidarity and OPZZ unions applied for licenses for private pension funds in joint ventures with international firms.

<sup>5</sup> For example workers retiring by 2006 were “grandfathered” into the old system, exempting them from new rules restricting early retirement.

More importantly, the new government took the strategic decision to prepare an entirely new law regulating the first pillar, rather than amend existing provisions. This would allow them to combine a large number of laws and regulations into one text and fold separate groups, such as the uniformed forces, in the larger system. But it also opened a broad range of thorny issues for debate. The decision slowed down the deliberative process and watered-down the reforms but, most agree, broadened support for the final product.

Fortunately, a new Plenipotentiary, Ewa Lewicka, provided strong leadership for the second phase of reforms. A modified program was sent, once again, to the tripartite commission in March 1998, resulting in significant revisions to government drafts. Trade union representatives pressed successfully for retention of early retirement rules for miners but were unsuccessful in other areas. The OPZZ federation complained that it could not keep up with the rapid changes in the draft laws. Lewicka pressed unsuccessfully for adoption of a uniform retirement age for men and women. There was no formal endorsement by the tripartite commission this time but unions did not mobilize against reform. Instead, they reached agreement with the government to subsequently resolve the thorny issue of privileges for certain occupations.

Additional consultations were held with government agencies, primarily the MOF and Ministry of National Defense, as well as the Catholic Church. Before the draft laws were sent to parliament, judges were excluded from the mandatory system on the advice of the Prime Minister's legislative department. Indexing of benefits, the size of pensions relative to wages, income redistribution, elimination of privileges for specific occupations, exemptions of prosecutors and some military personnel were all debated intensively. Final passage was delayed when miners occupied the Ministry of Labor for two days to demand that the government extend early retirement options for miners. Other strikes by OPZZ continued. Parliament finally completed consideration through a series of votes, some with a majority from the government coalition but others with Freedom Union-SLD support. The overarching Social Security law was passed in August 1998 and the first-pillar law was approved in December 1998. Because of delays in passage,

some implementation deadlines were pushed back to April 1999.

### *Conducting Public Outreach*

In May 1997, as Parliament considered the "Security through Diversity" program, the Office for Pension Reform (OPR) launched a public relations campaign that targeted policymakers, political leaders, unions, employers, and the media. The campaign stressed the long-term insolvency of the current system and the necessity of comprehensive reform. The Office conducted public opinion surveys and widely publicized the results, organized seminars, developed a recognizable logo for the Office, held training programs for OPR and ZUS staff in communications techniques and the principles of the proposed new system, maintained a website, and produced thousands of brochures targeted to employers, unions and different age groups. The OPR put considerable effort into media relations, arranging interviews with key architects of reform. Members of the media joined Parliamentarians and government officials on a study tour to four countries that had undertaken comparable reforms and this greatly informed their reporting.

Early press releases outlined experiences with pension reform in other countries and developments in the legislative process while later ones explained the specifics of proposals adopted in Poland.

### *Launching the New System*

Revamping a national pension system is no small task but, to date, important steps have been taken:

- In February 1999, the new pension fund regulatory agency (UNFE) began issuing licenses to some 21 private pension funds and registered over 300,000 sales agents; it also worked hard to monitor their activities, particularly advertising and sales practices;
- A massive public education campaign was developed to provide information to the public – before advertising was permitted by private funds -- on the new choices facing many workers and the need to select a pension fund;
- By the deadline of December 1999, most of the 11 million workers between 30 and 50

years of age had selected a pension fund and workers and employers had contributed the first \$13 billion in assets.

The performance of ZUS was a disappointment during this period. Its local offices were overwhelmed by customers eager to get information about the new system. Its central offices struggled to modernize the information technology system and train its workforce. As a result, there was a several-month delay in tracking individual contributions and passing them on to private pension plans, as required by law.

It is far too early to draw conclusions about system performance and certain issues, such as bridging pension schemes and creation of an office for supervision of long-term actuarial aspects, remain to be clarified. But a policy framework has been put in place that sets the conditions for improved management and operation of the pension system over the long term.

### *The Second Public Outreach Campaign*

By the end of 1998, continued polling indicated clearly the need to shift from opinion-leaders to the general public. Only 30 per cent of people surveyed said they had heard of the pension reform and understood the changes proposed. Some 55 per cent had heard of a reform but didn't know the specifics. Some 83 per cent felt they were not sufficiently well informed and 77 per cent said they would like to learn more.

In March 1999, as mentioned above, a second, broader campaign launched with objective of explaining the new system and the different options open to different age groups. Conflicting information was put out by various pension funds with massively larger advertising budgets (\$100 million compared to \$5 million spent by the government). Software for estimated pension benefits could be downloaded from the OPR website. A call center was created which handled 200,000 inquiries from March-December 1999; press, television spots and brochures promoted the call center and the new ZUS; four televised spots reached an estimated 96 percent of urban adults; booklets were included with monthly telephone bills.

With outside consultants, the OPR used focus groups to track the effectiveness of outreach efforts

and, where necessary, make mid-course corrections. Initial results were disappointing. People could recall slogans but did not understand what they meant. Focus groups indicated that the key sources of information for people were conversations with friends, press articles and, literature produced by private pension funds. ZUS was a last resort and associated with old system.

The office of the Plenipotentiary was officially dissolved in April 1999 but some of its employees continued work from within the Ministry of Labor. Focusing on opinion leaders to educate key publics, Lewicka traveled to eight of the largest cities outside Warsaw in May and June 1999. She met with employers, trade union representatives and local media. A new communications strategy, adopted in August, developed new television spots and added radio. Newspaper advertisements answered the most common questions identified by focus group participants and cautioned the public about possible excessive claims by private funds.

Additional focus groups indicated that people realized that pension funds were providing subjective and general information and that information from the Office of the Plenipotentiary was considered more reliable than ZUS. People had four key questions:

- Are pension funds reliable?
- What are the differences between them?
- How should people decide between splitting the pension contribution or staying in the public scheme?
- What are government guarantees of pension fund performance and benefits?

Public education efforts continue and the UNFE also ran a limited information campaign and held visitor hours in its offices. Officials appeared on radio and TV programs and joined debates and conferences, mostly aimed at supporting employers and unions in setting up voluntary "third pillar" schemes. Rather than producing easy-to-use explanatory tables, the UNFE proposed new cost structures that created new confusion. But, as noted, they played a very constructive role in monitoring the advertising and sales blitz conducted by private pension funds in 1999.

### **Conclusions**

*Special offices created early in the process were very important in coordinating reform and*

*signaling high-level commitment.* The Prime Minister recognized the need for a Plenipotentiary to devote intensive resources to reform without having the day-to-day management of the pension system. The plenipotentiaries, in turn, led public campaigns and successfully shielded the Office for Pension Reform from political fights, enabling it to focus on professional tasks. When necessary to sustain reform, key cabinet appointments were made.

*The government built support outside its own governing coalition that was essential for sustaining reforms.* This was particularly important in light of changes in government. The support of opposition deputies was essential to approval of key aspects of the first-pillar law.

*The government effectively reached out to trade unions and business associations before finalizing legislation for Parliament.* Cooperation from trade unions was clearly an essential element of achieving reforms in Poland. The thrust of the “Security through Diversity” program was consistently supported by the Solidarity movement and the OPZZ and both were intimately involved in consultations, along with business associations. The tripartite commission was used effectively by both governments to vet proposals, hash out compromises and, where possible, reach agreement.

*The broad consensus carefully constructed during the reform process slowed the pace and content of reform but contributed significantly to implementation.* Trade unions, brought in as partners during the coalition-building, as playing a key role during implementation; they are directly involved in both the second and third pillars. The Catholic Church, also consulted during the reform process, has a 20 percent ownership of a pension fund and an estimated one-fifth of its priests have helped to attract clients.

*Important concessions made to build support will significantly increase transition costs but do not undercut the essential objectives of the reform.* Adjustments in retirement age, exclusion of selected groups, retention of some early retirement privileges and “grandfathering” of current rules until 2006 will cause the pension system to operate in a deficit for an additional seven years. But it will eventually achieve its original objectives:

Reduce the demographic risk to the financing of the system by shifting from defined benefits to defined contributions (i.e., a funded system);  
Strengthen the linkage between contributions and benefits;  
Insulate benefits from ad hoc manipulation by reducing the role of the annual budget process;  
Steadily reduce contribution rates over time from high level imposed in the mid-1990s;  
Reduce required budget subsidies over time;  
Reduce incentives for early retirement that previously applied to approximately 24 percent of the workforce.

*Not only the government but trade unions and other organizations faced difficult trade-offs.* The loss of early retirement options and other occupational privileges and a decline in the level of pensions from 1994 levels is a difficult blow. But there was an assessment that the relatively exceptional circumstances in the mid-1990s were not sustainable over the long-term and the trade unions are now a full partner in the new system.

*The long-term prospects of the new system appear good.* Benefits paid under the first pillar are linked to wage growth and benefits paid under the second pillar are linked to the rate of return on pension fund investments, thereby diversifying risks for the system as a whole. Nonetheless, individuals face uncertainties about the size of benefits and the government faces uncertainties related to the economy, political factors, such as changes in benefits or indexation, and performance and efficiency of the private pension funds which must ultimately be guaranteed by the government.

*New stakeholders created during the reform will play an increasingly important role.* “The pension funds will be the most powerful financial institutions in the country,” according to one church official in Poland. It is essential that reformers set up the appropriate regulatory mechanisms not only to treat existing stakeholders but future ones as well.

*The decision to expand the role of ZUS has created difficulties in implementation.* ZUS was given expanded responsibilities and has not moved quickly enough to meet them. Public confidence in the agency remains low. Its highly decentralized structure has to be significantly revamped and its staff upgraded. It needs to develop a new system capable of tracking the individual accounts of all

retirees, including actual balances in the second pillar and “notional” or estimated accounts in the PAYG pillar.

*In general, public outreach and communications efforts were effective.* The Plenipotentiary was viewed as a credible source of information by a public that was quite savvy about evaluating information. The government made very good use of public opinion polls and focus groups to: demonstrate public support for reform; design a program likely to garner support; identify controversial elements; and guide public education programs and provide timely feedback about their effectiveness.

Opinion polls taken at this time indicated that the proportion of people who felt their information was adequate or improved had increased from less than half in late 1998 to nearly 80 per cent. Just 16 per cent said they felt they lacked information, compared to nearly half earlier. Approximately 50 percent of respondents thought information was easy to find and, by March 2000, this proportion had risen to 70 percent.

The second public information campaign faced the difficult task of explaining the new system. Polling suggests that important progress was made but there are grounds for concern. Some 91 percent were aware of the government campaign but only one-third assessed it positively and forty percent were critical and felt that information was not conveyed clearly enough. Much of public knowledge remains limited to slogans and basic questions remain unanswered.

*The media played a key role throughout the reform process and one of the most effective investments of government resources was in media outreach and education.* Focus groups consistently identified the media as an important source of information. The bulk of stories covering pension reform were not opinion pieces but informational articles explaining various aspects of pension reform and their implications. When, in early 1999, press coverage of government social programs turned negative, pension reform continued to be cited as the exception and was considered relatively well prepared.

### *Final Remark*

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The Democratic Left Alliance government opted to retain the initiative, keep momentum building, and correct mistakes later. The Solidarity Electoral Alliance and Freedom Union government opted to work through a full drafting of legislation in the

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Parliament, moving at a painstaking pace and slowly resolving all issues. Despite these differences, both governments combined technical expertise with a strong commitment to consultation and coalition-building that is striking. Civil society actors, despite the highly technical issues involved, were full participants and contributed significantly to the final product. A large portion of the public feels that information on the reforms has been made easily accessible. These are important achievements in an operating environment of crisis management, limited resources, and competing priorities.

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