



The Sustainability and Adequacy Tradeoff as Countries Age

- the lesson from Poland

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Outline

- The need for the pension reform in late 1990s
- Shaping the pension reform in Poland
 - „Security through diversity”
- 15 years of reform implementation
- Pension reform reversal
- Sustainability and adequacy of pension system in the future

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

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)
 - Mandatory 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”

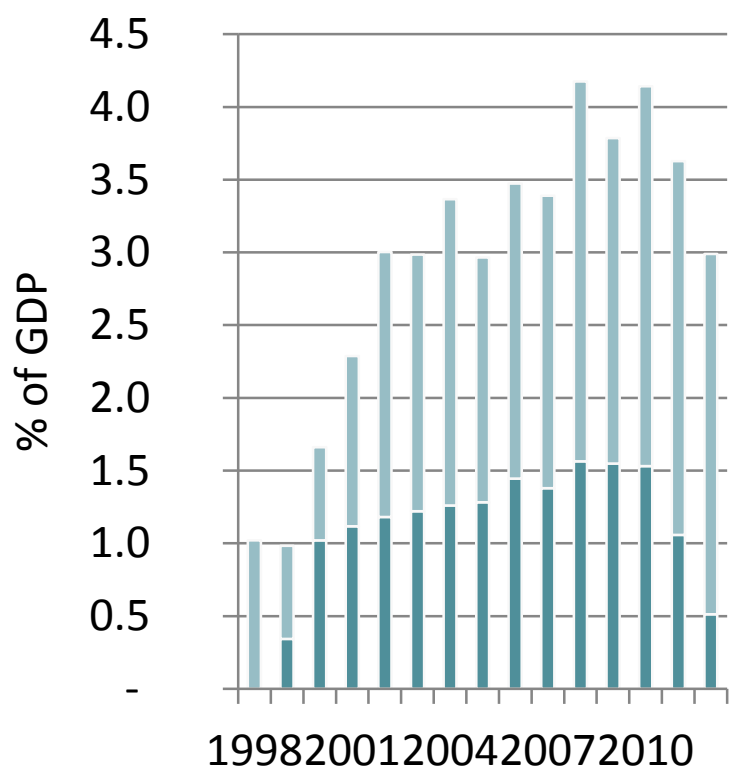


- Projected reform outcomes:
 - Regaining financial stability in the long run: close to actuarially balanced pension formula
 - Transition costs financed from privatisation revenue, savings in pension system (limiting early retirement) and from the state budget
 - Incentives to postpone retirement decisions
 - 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

15 years of reform experience

- Demographic situation:
 - Persistent low fertility
 - Rising life expectancy
 - Migration (particularly after EU accession)
- From one of lowest to one of highest dependency rates in EU between 2000 and 2060
- Labour market
 - Falling employment level between 1999 and 2003
 - 1997 level reached only in 2007
 - Employment growth slower after 2008

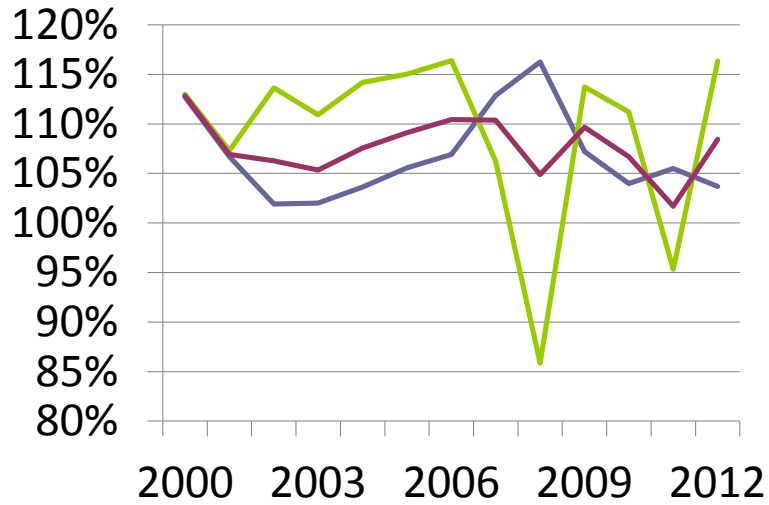
15 years of reform experience



- government subsidy to SI
- transition costs (FDC contribution)

- 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
- Further rise of retirement age to 67 by 2020 (men) and 2040 (women)

15 years of reform experience

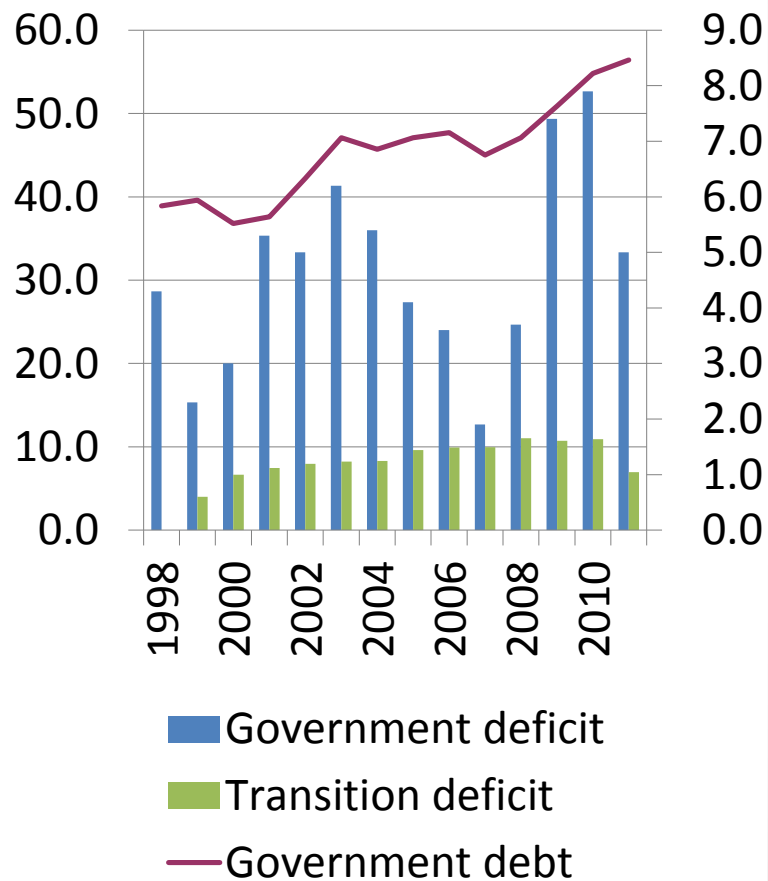


- nominal return NDC (ZUS 1)
- nominal return FDC (OFE)
- overall return (NDC+ FDC) - initial contribution split

- 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

Fiscal situation and reform reversal

- Contribution rate to FDC reduced to 2.3% in May 2011
- 5% of wage recorded on quasi-NDC account (indexed to GDP growth)
- From February 2014 contribution at 2.92%
- In February 2014 assets invested in government bonds (9% of GDP) transferred to PAYG scheme and redeemed
- In 2014 system made opt-out and opt-in in specified time slots (first slot: April-July 2014, second in 2016)
- Assets from FF transferred gradually to PAYG 10 years prior to retirement



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

	Fertility	Dependency rate	Employment	Pension expenditure	Pensioners	Performance of funded pillar	Government deficit	Government debt	Pension system change after crisis
Poland	-	-	+	-	-	+	-	-	Permanent reduction and partial reversal

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
- Population ageing puts significant pressure on labour market development which will affect pension system
- NDC design ensures long-run financial sustainability, albeit on much higher level of public expenditure
- Adequacy of pension benefits improved by increased retirement age

Thank you

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