

# Pension reforms in Central and Eastern Europe (CEE): The case of Poland

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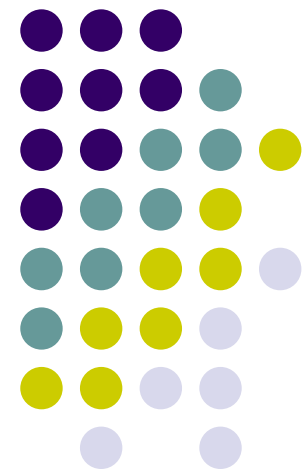
**European Pensions and Investments Conference**

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**Robert Sierhej**

**International Monetary Fund**

**Regional Office in Warsaw**



# Outline of the presentation



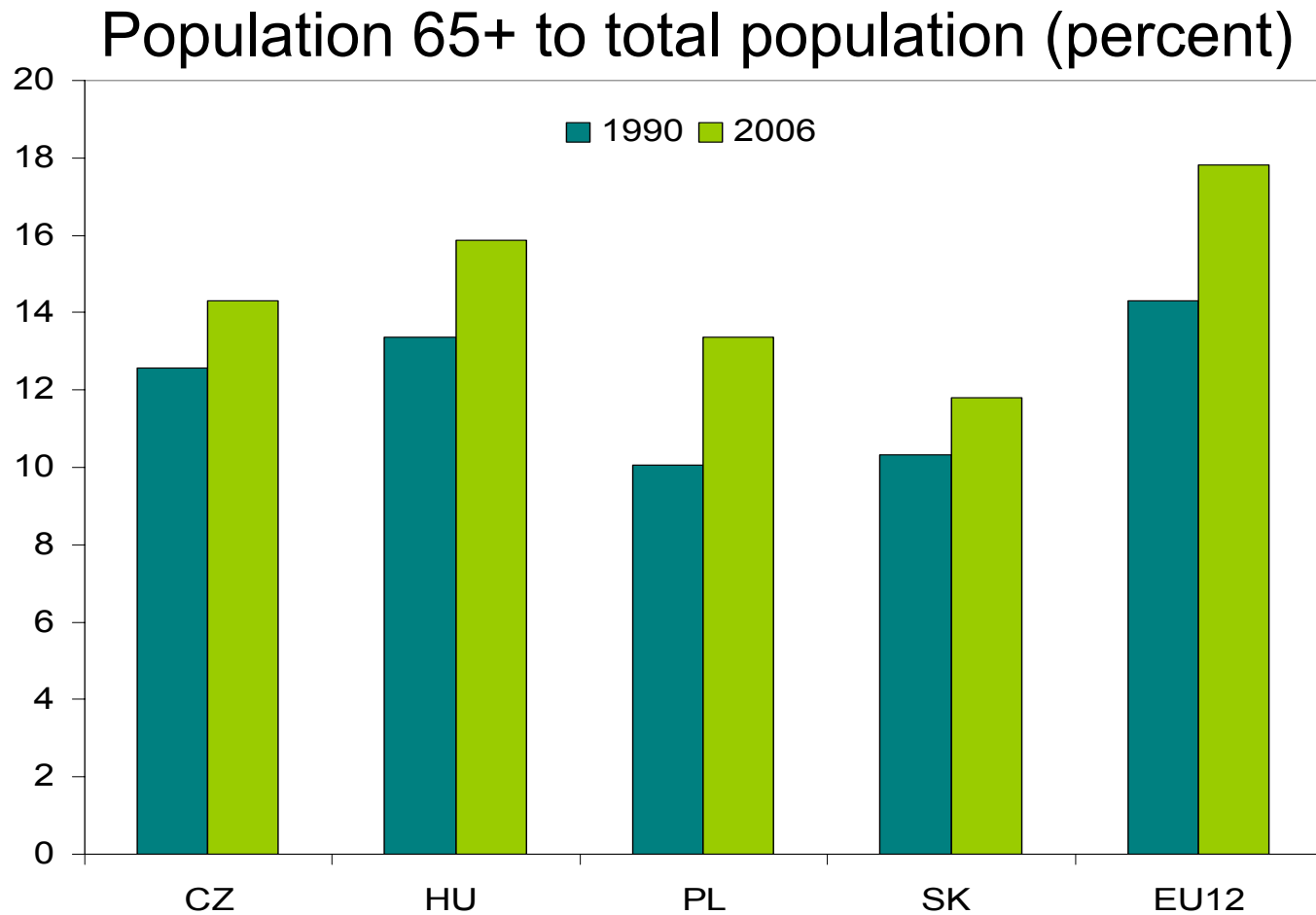
- Why do CEE pension systems need reforms?
- Pre-reform pension developments in Poland
- The Polish pension system after reform
- Private pension funds in Poland
- Unfinished agenda and future challenges



# Part I:

- Why do CEE pension systems need reforms?
- Pre-reform pension developments in Poland
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# While the demographic situation in CEE is favorable compared to EU12...

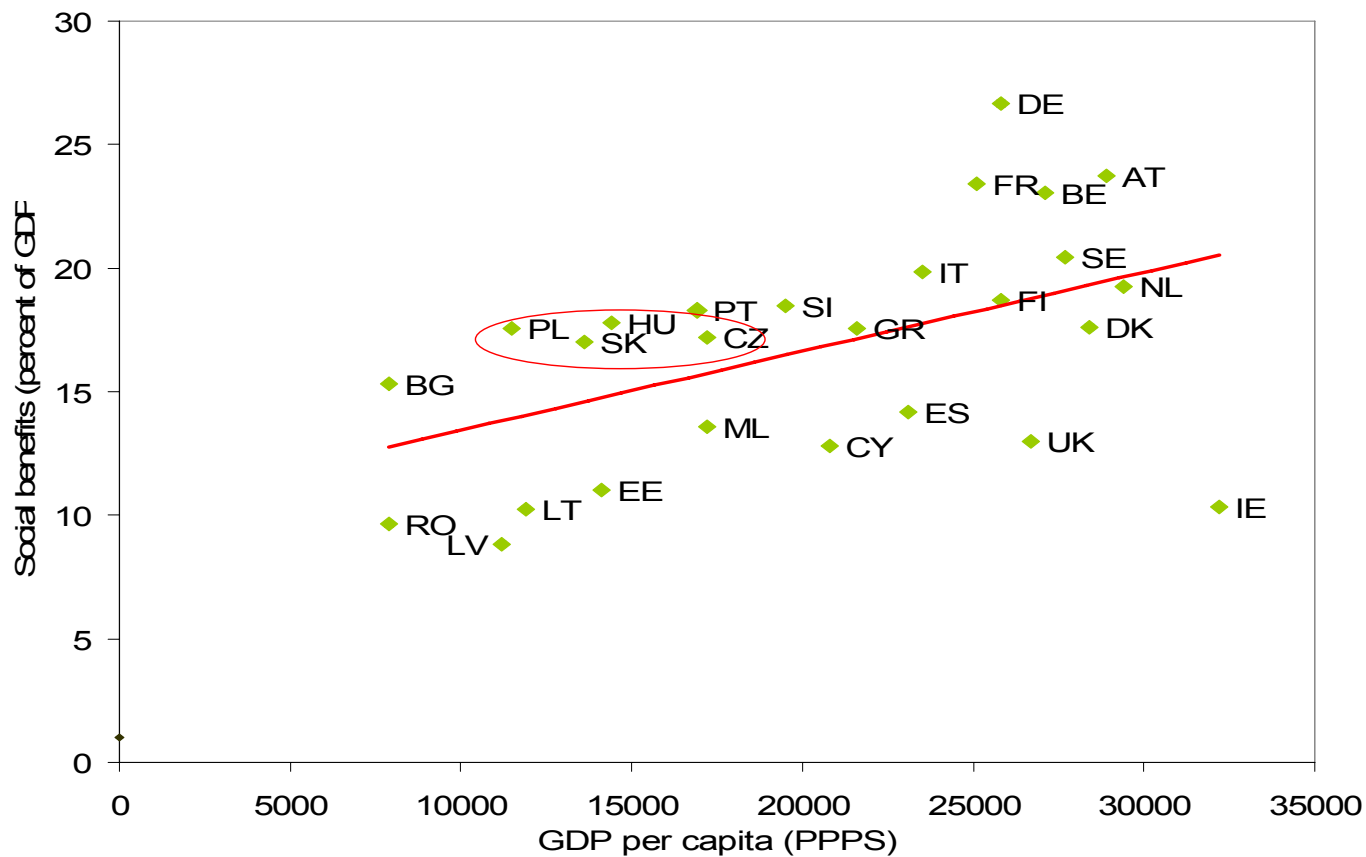


Source: Eurostat.

# ...social spending is relatively high



Social benefits 2005 (percent of GDP) and GDP PPS

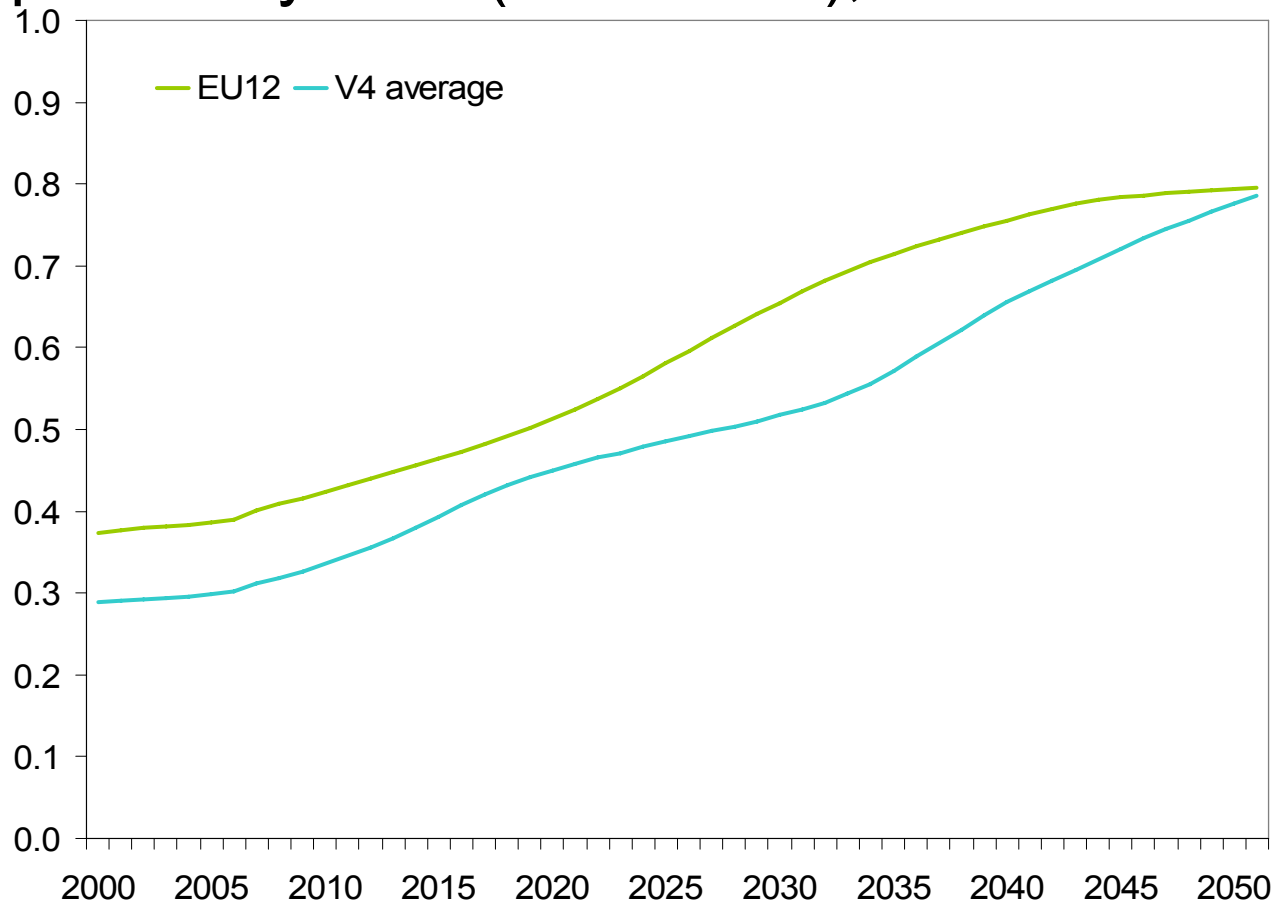


Source: Eurostat.

# Long-term projections point to unfavorable demographic trends

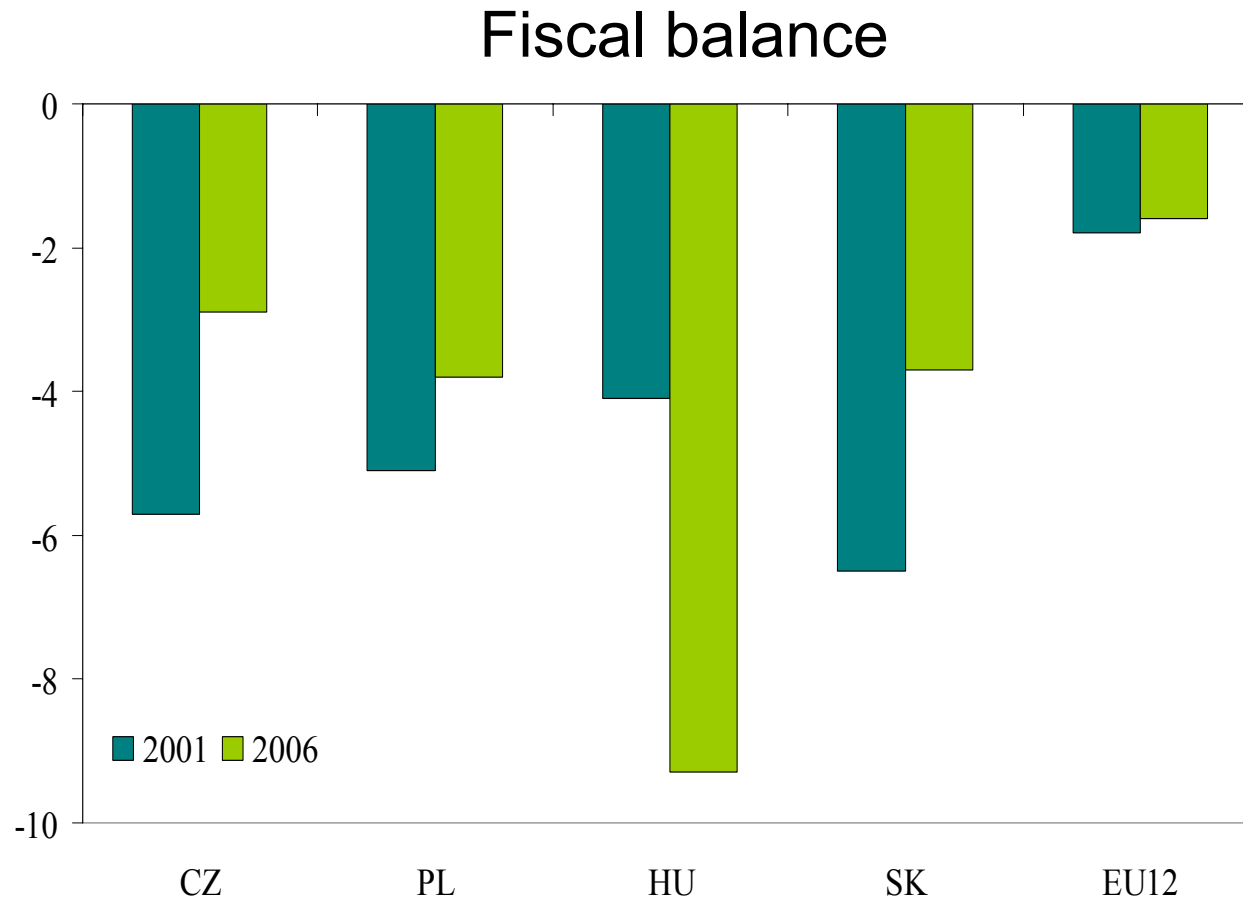


## Dependency ratio (60+/18-59), 2000-50



Source: Eurostat.

# Fiscal positions provide little cushion against population ageing



Source: Eurostat.

# Most CEEs implemented changes in their pension schemes:



- Numerous parametric changes to put PAYG schemes on a stronger footing, for example:
  - reducing early retirement provisions
  - changes in benefit calculation formulas
  - limiting occupational privileges
  - changes in the indexation of benefits
  - increase in the retirement age
- Some CEE countries diverted part of social security contributions to mandatory private pension funds: Hungary, Slovakia, and ***Poland***

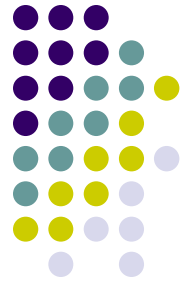


# Part II:

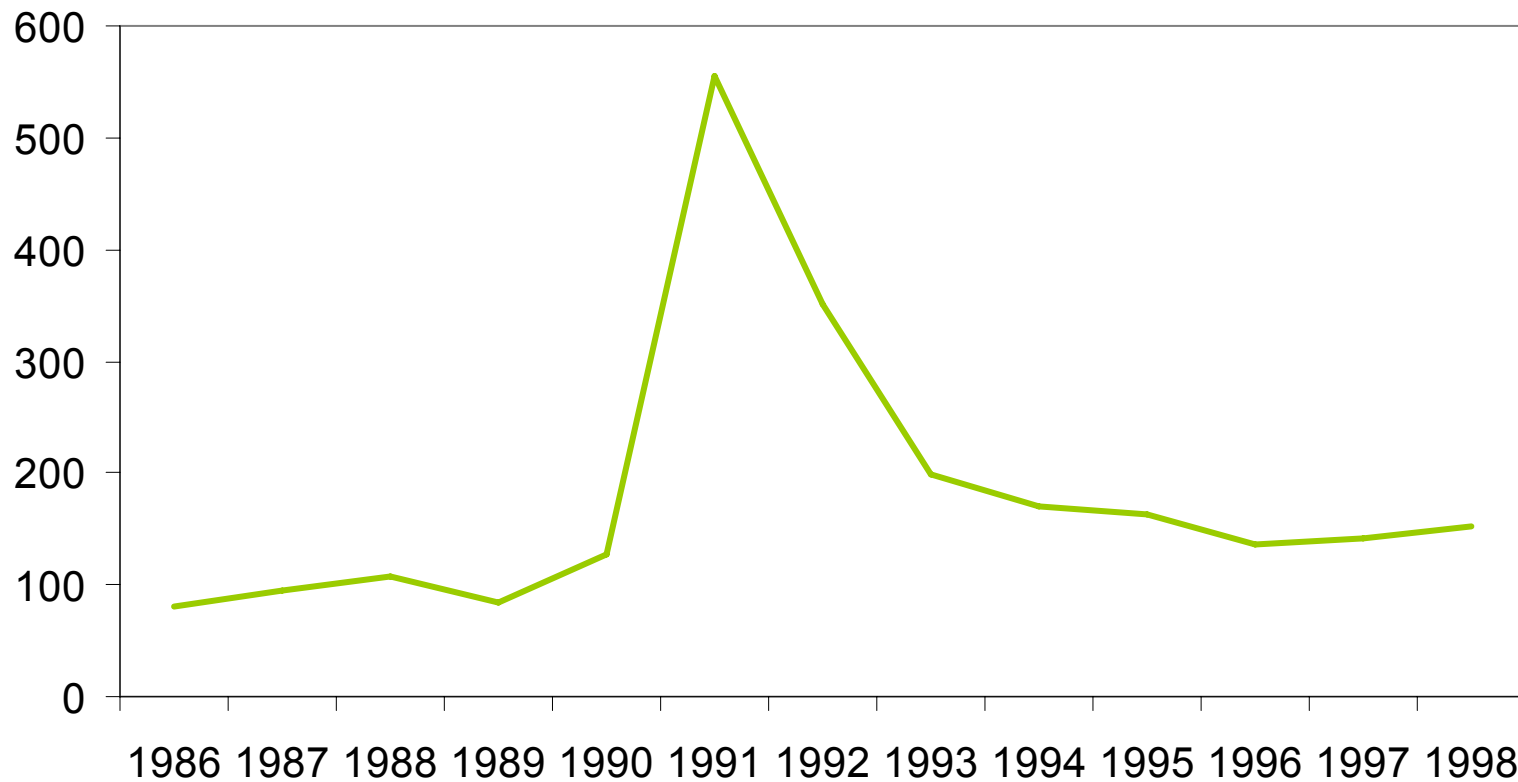


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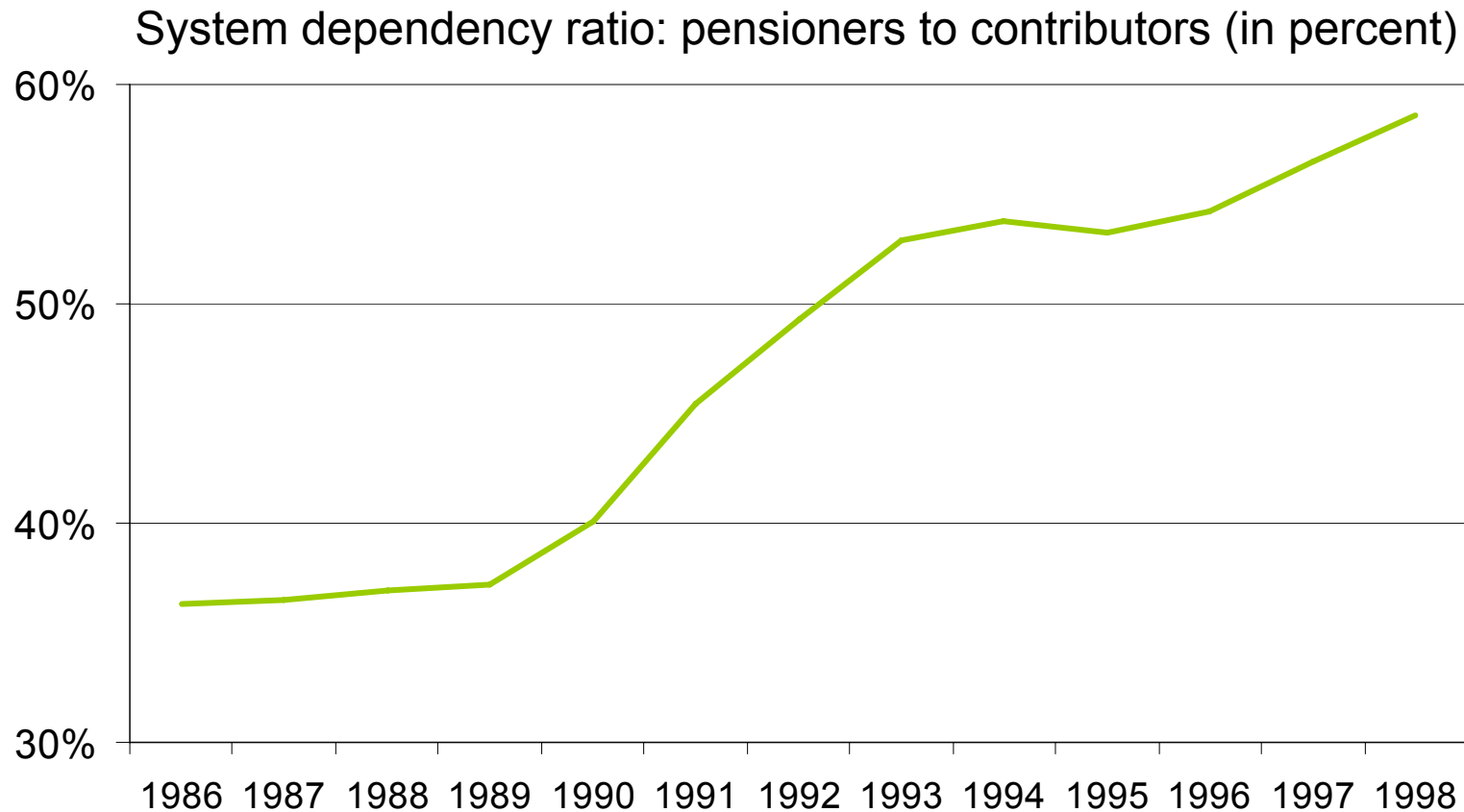
# The Polish pension system acted as a 'transformation buffer' in the 90s



Annual change in number of pensioners (thousands of persons)



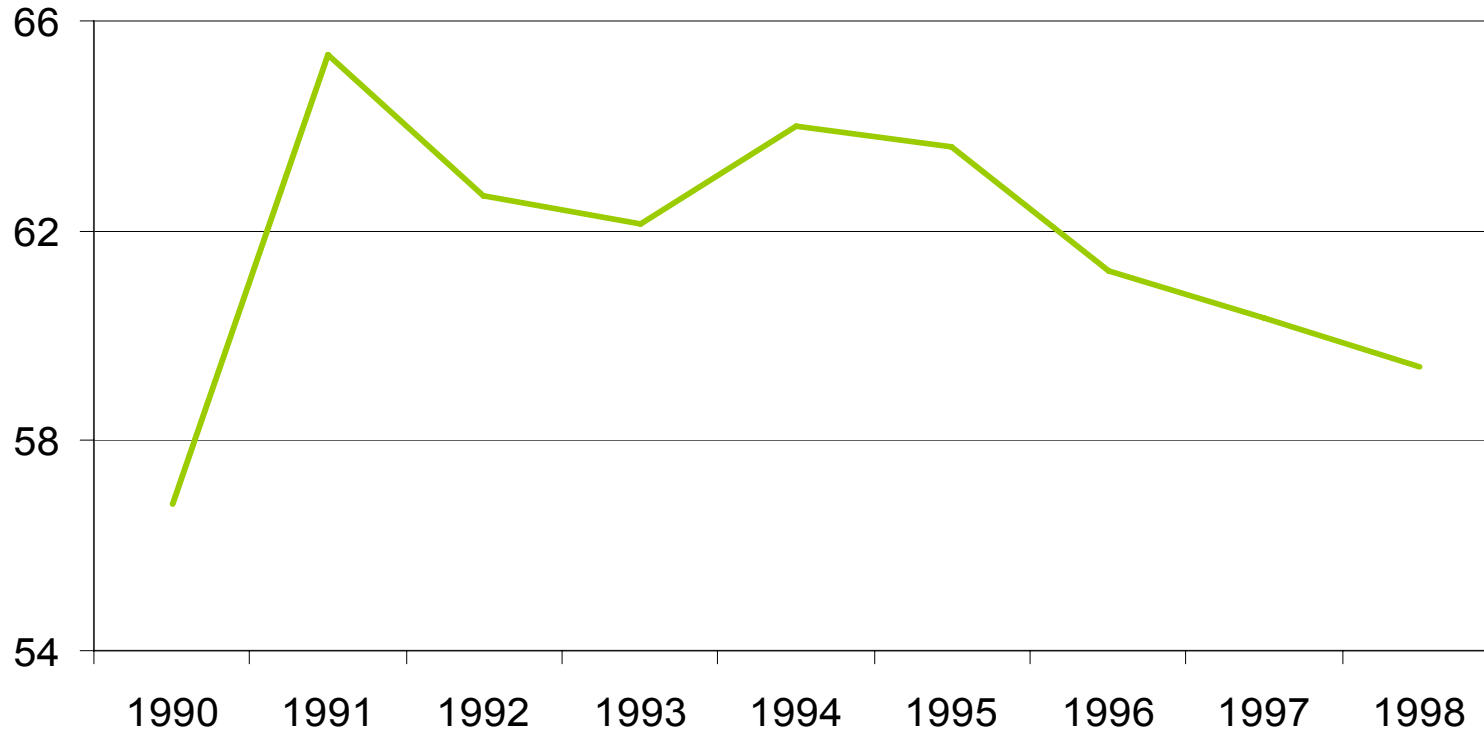
# Consequently, the burden on working population has increased



# At the same time, replacement ratio has increased despite ad-hoc measures...



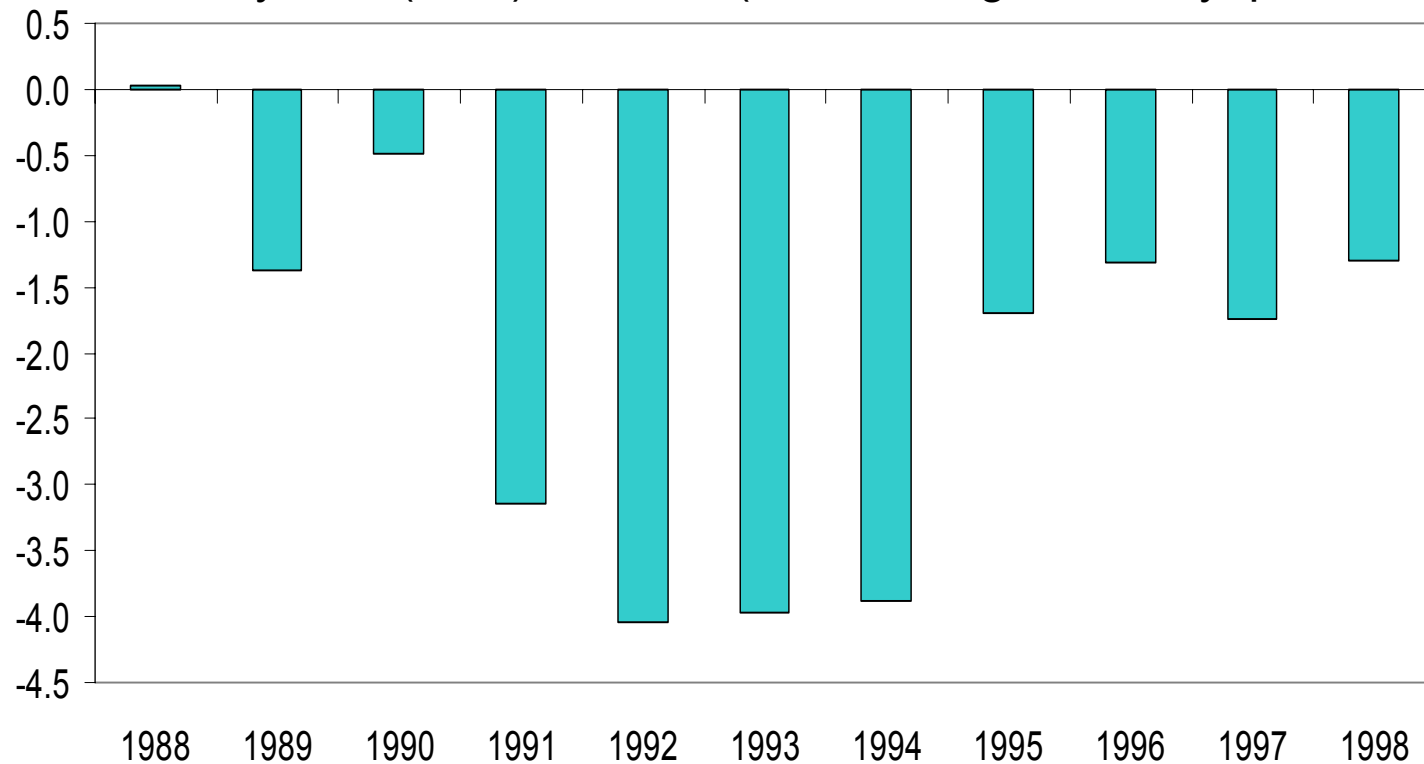
Replacement ratio: average old-age and disability pension to average wage  
(in percent)



# ...and the social security fund was in large deficit



Social security fund (FUS): balance (before budget subsidy, percent of GDP)



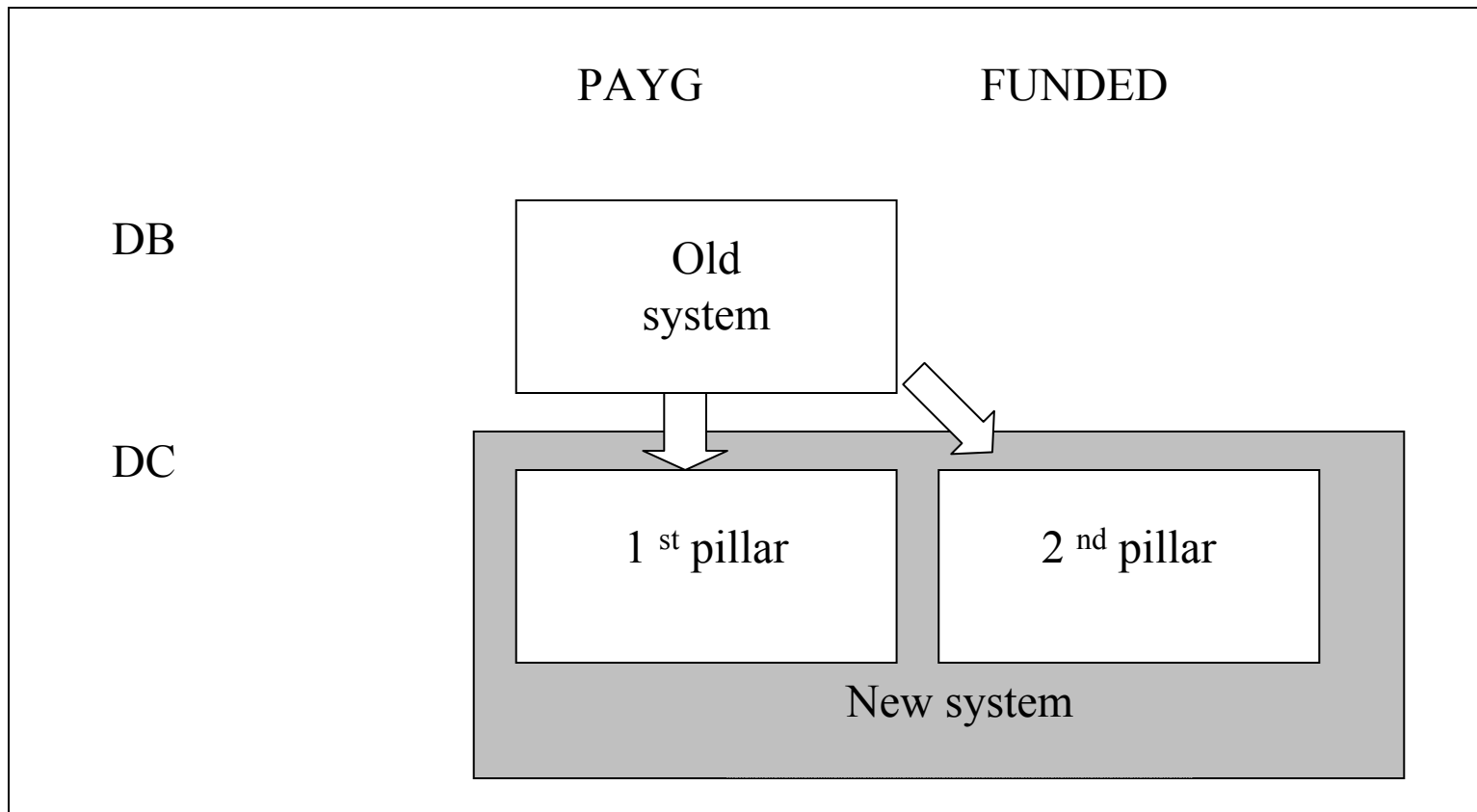
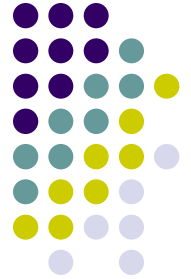
Source: MoF and ZUS.

# Part III:



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# Basic features of the Polish pension reform in 1999



# Expected impact of the reform



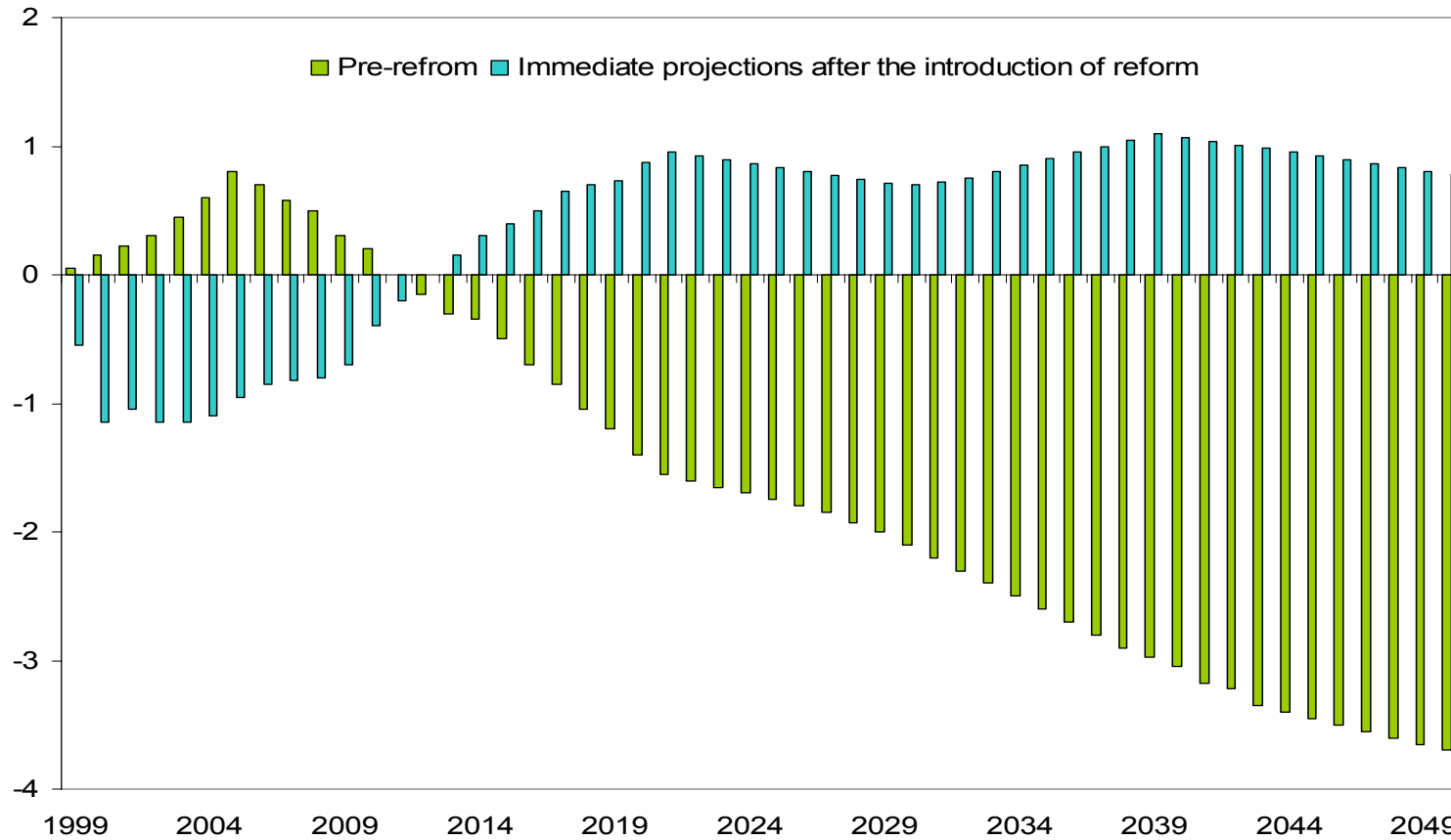
- In the *long-run*, the reform was expected to improve social security finances by:
  - lowering the replacement ratio for future pensioners
  - increasing effective retirement age—inter alia by eliminating expensive pockets of early retirement
  - shifting longevity and market risk to beneficiaries
- In the *short-run* the reform implied transition cost as part of the contribution was diverted to private funds
- On balance, the result was expected to be strongly positive



# The reform was expected to stop deterioration in social security

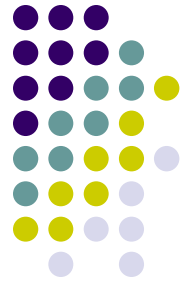


Poland: The fiscal impact of the 1999 Pension Reform  
(The balance of the state-managed part of the pension system relative to GDP)



Source: Chłoń, góra, Rytkowski, *Shaping pension reform in Poland: Security through Diversity*, Social Protection Discussion Paper No. 9923, August 1999.

# Post-reform developments differed from assumptions

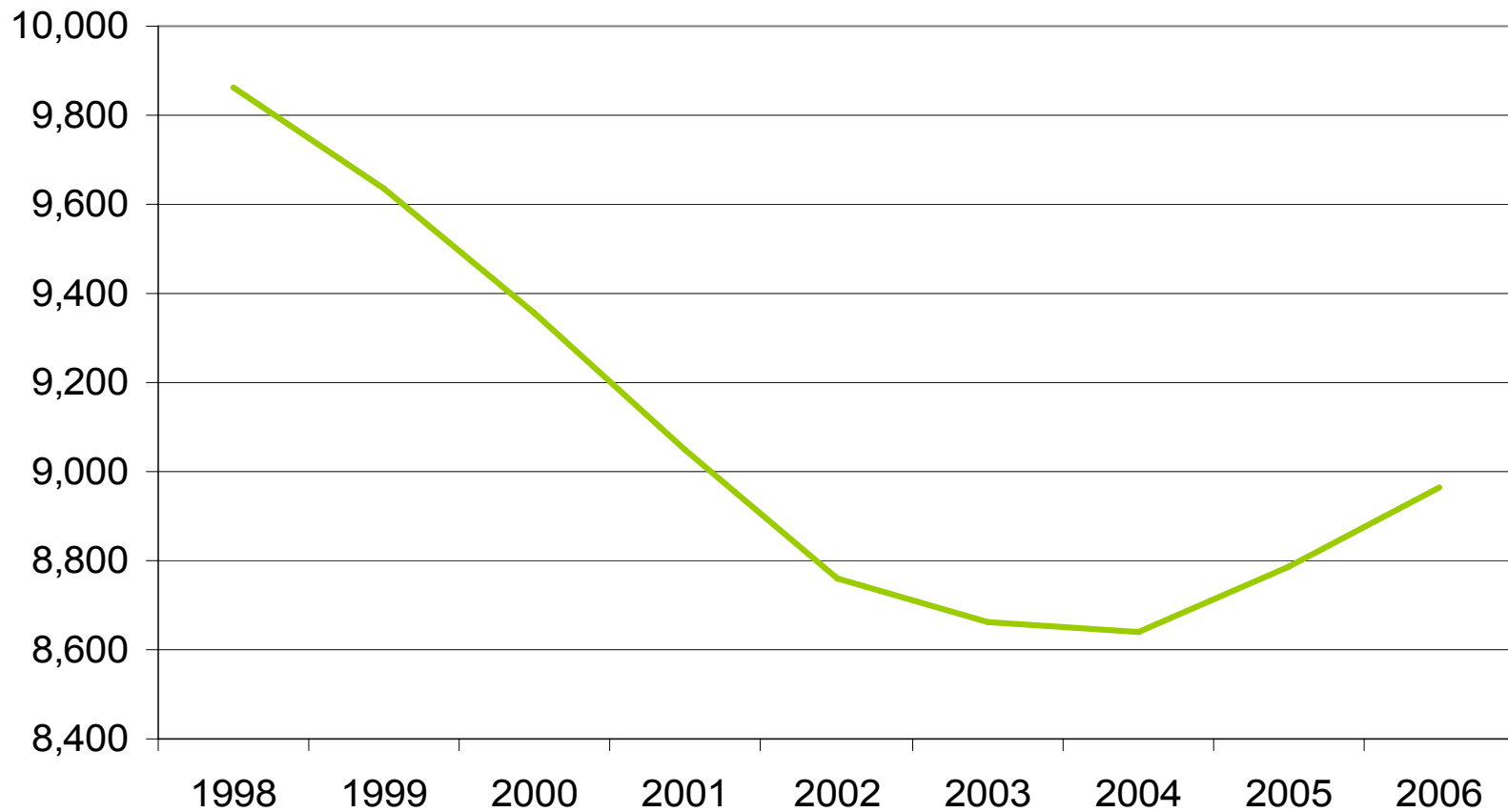


- Developments were less favorable, for example:
  - pensions increased faster than envisaged
  - the contractual employment declined
  - increasing self-employment weakened the contribution base
  - participation in the 2<sup>nd</sup> pillar was higher than expected
- As a result, the long-term turnaround in social security finances is not going to be as impressive as expected

# Contractual employment has declined...



Contractual Employment (thousands of persons)

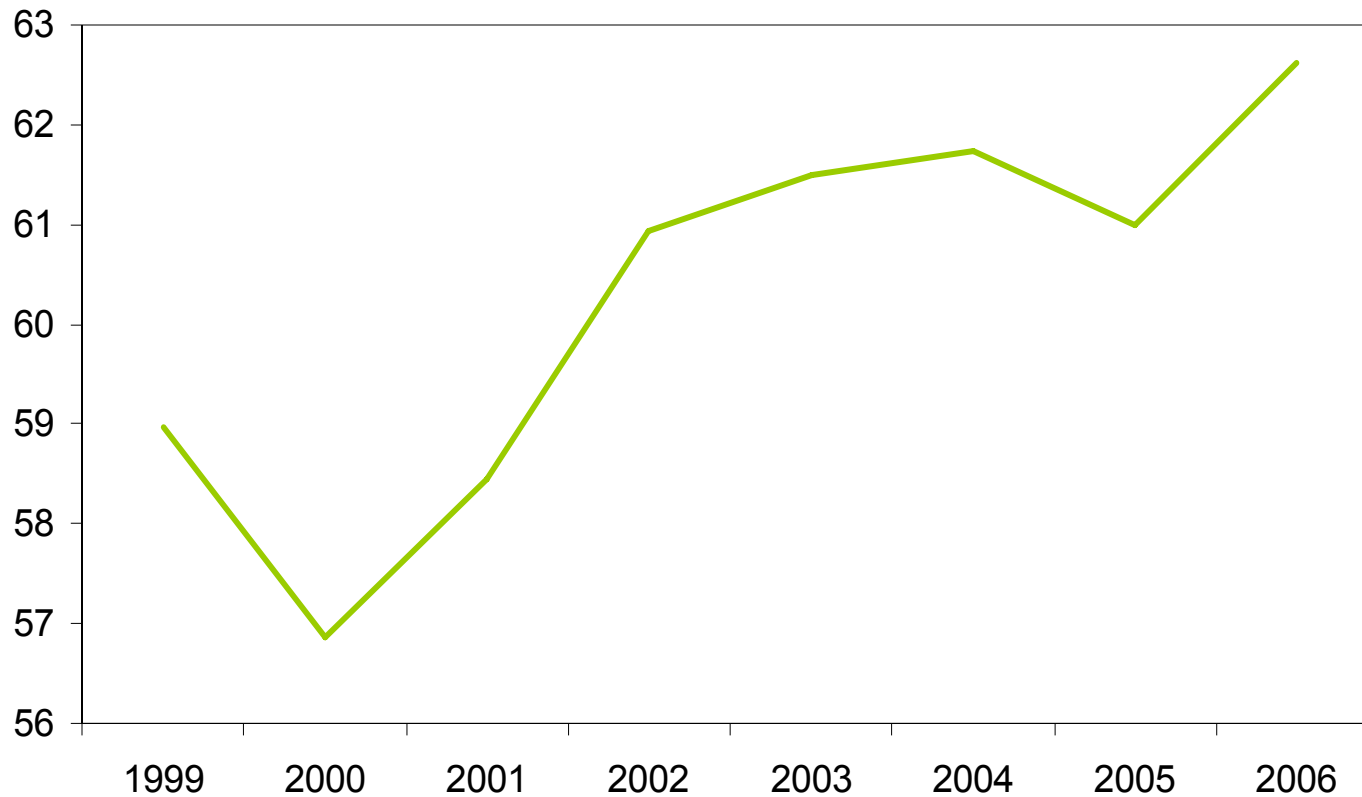


Source: GUS

# ...and pensions have been increasing faster than wages



Replacement rate (average pension to average wage, in percent)

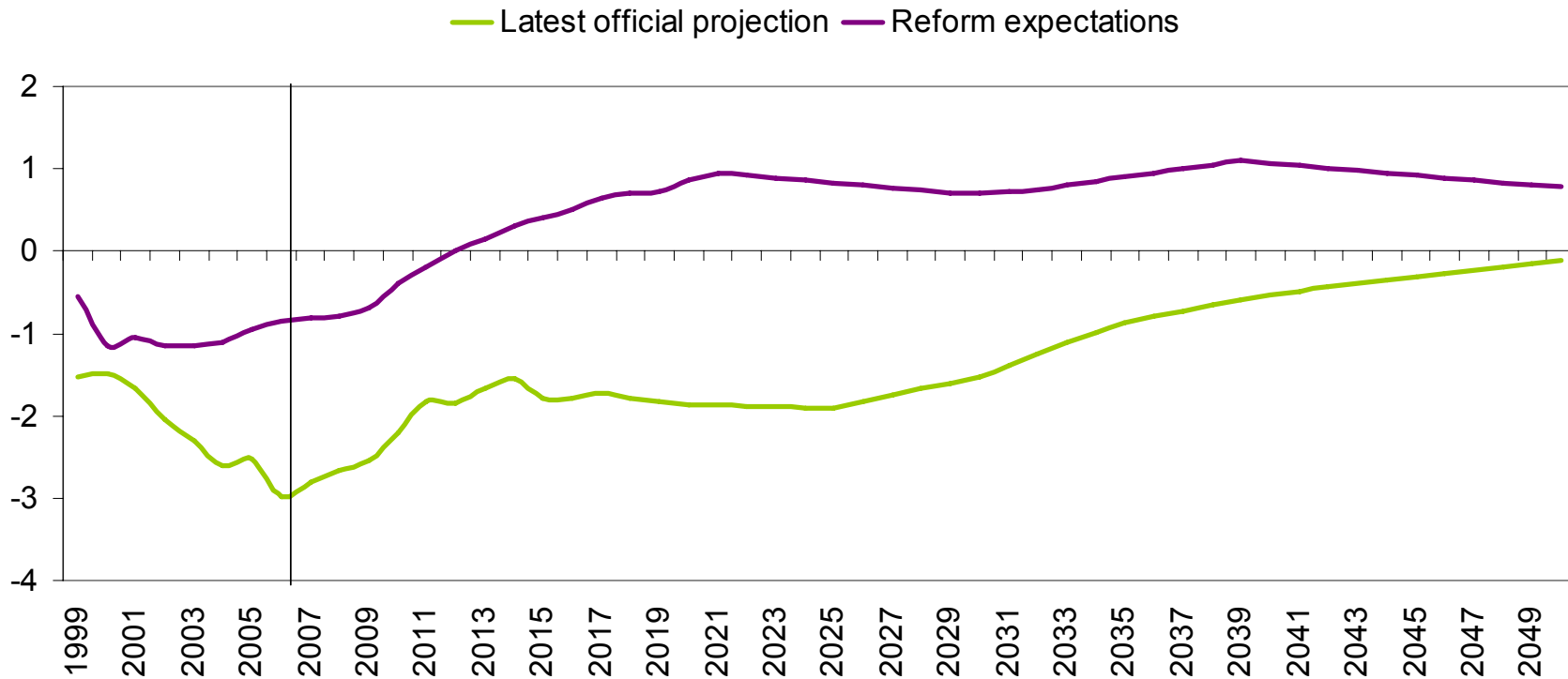


Source: GUS and ZUS

# Long-term improvement in social security looks less favorable



Balance of the state managed old-age pension fund 1999-2050 (percent of GDP)

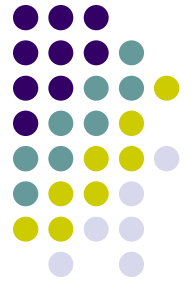


# Part IV:



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# Open pension funds (OFE) at glance:

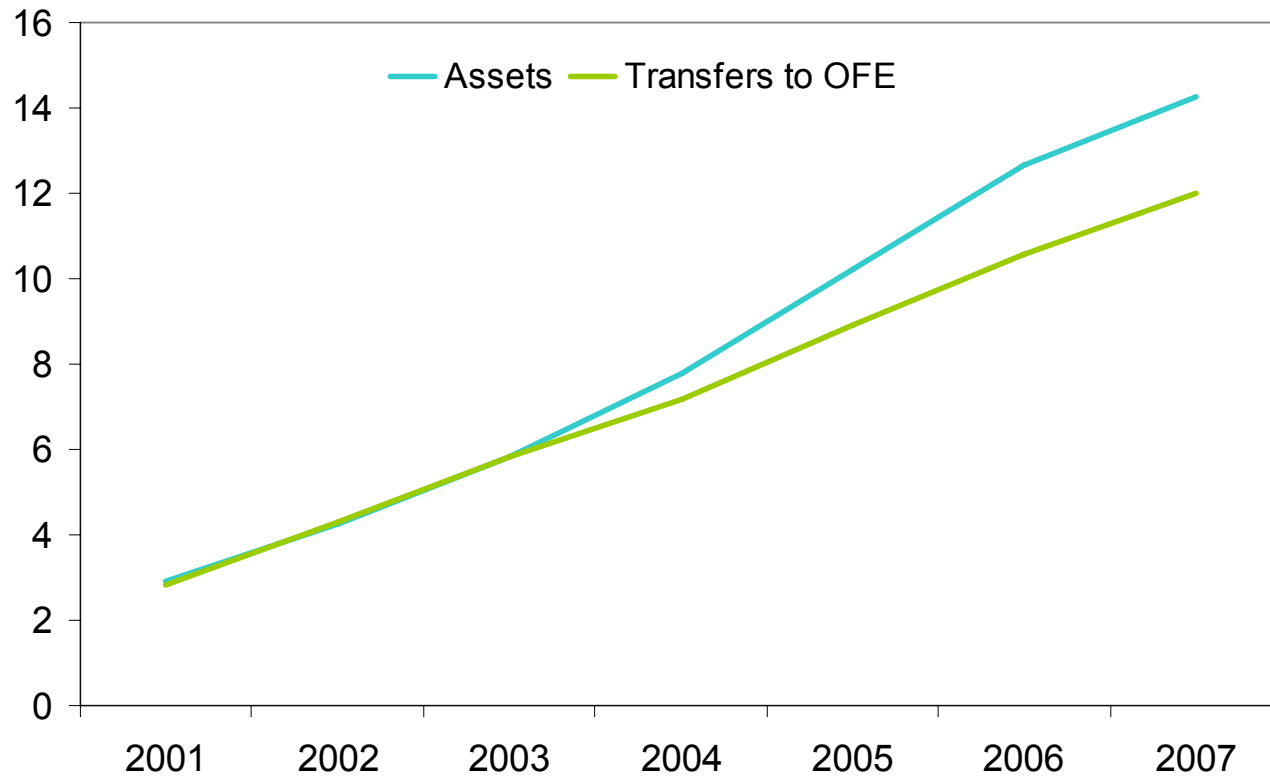


- *Membership*: mandatory for new entrants to labor market, voluntary for workers aged 30-50 at the time of reform, almost 10 million (80%) joined OFE (compared to 50% projected)
- *Contributions*: 7.3 percent of gross wage (12.2 percent for the state owned 1<sup>st</sup> pillar)
- *Fees*: on contributions (up to 7%) and on assets (up to 0.6%); some 1.6% of assets on average
- *Investment limits*: max. 5% foreign investments, max. 40% domestic equities, no limit on T-bonds
- *Minimum rate of return*: 50% (or 400 bps) below weighted average for all funds in last 3 years
- *Number of funds*: initially 21 OFEs, but declined to 15 after mergers; three largest funds account for 64% of assets

# Assets of pension funds are growing rapidly

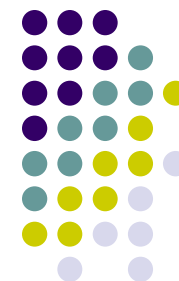


Assets of Open Pension Funds (percent of GDP)

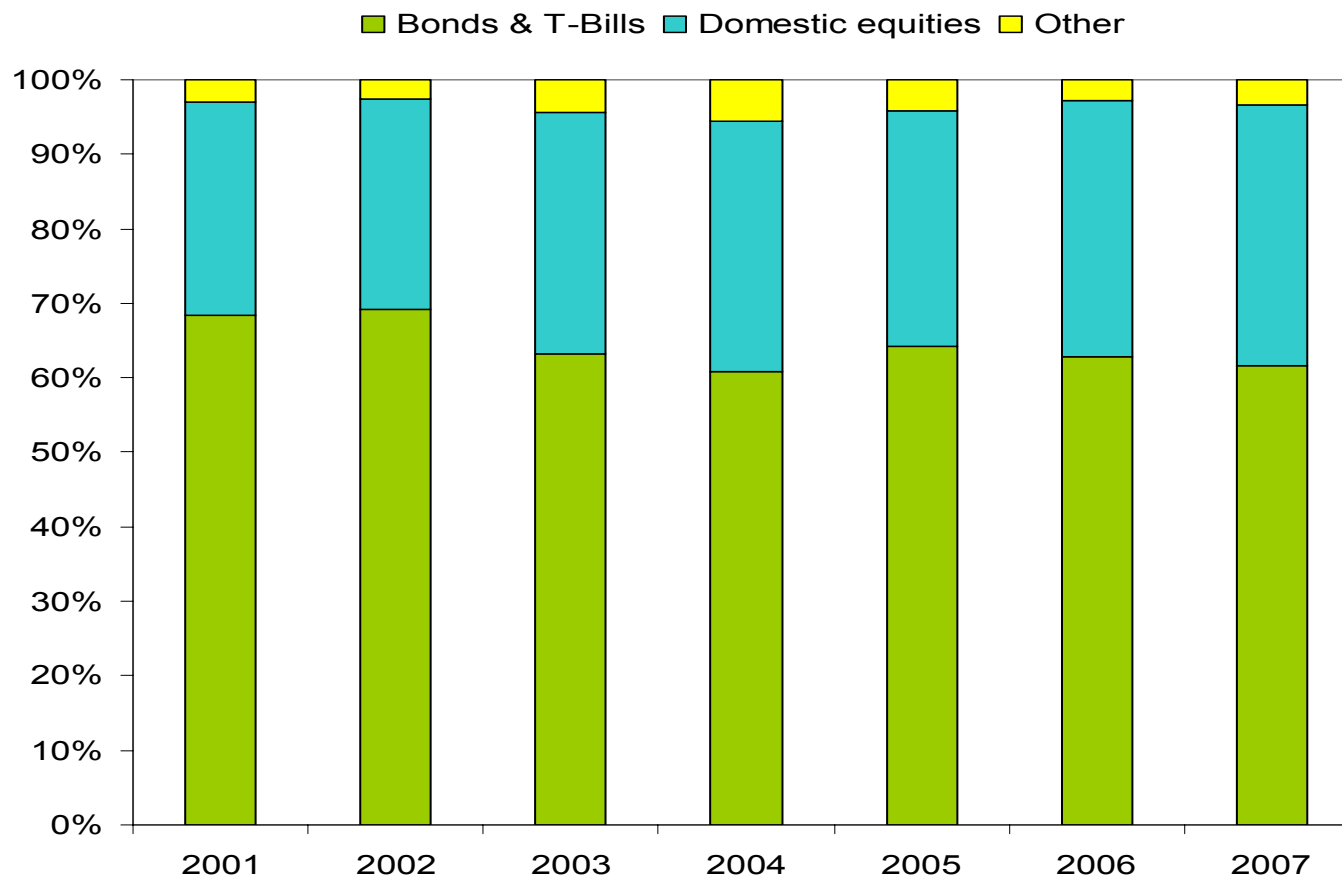




# Asset structure remains stable



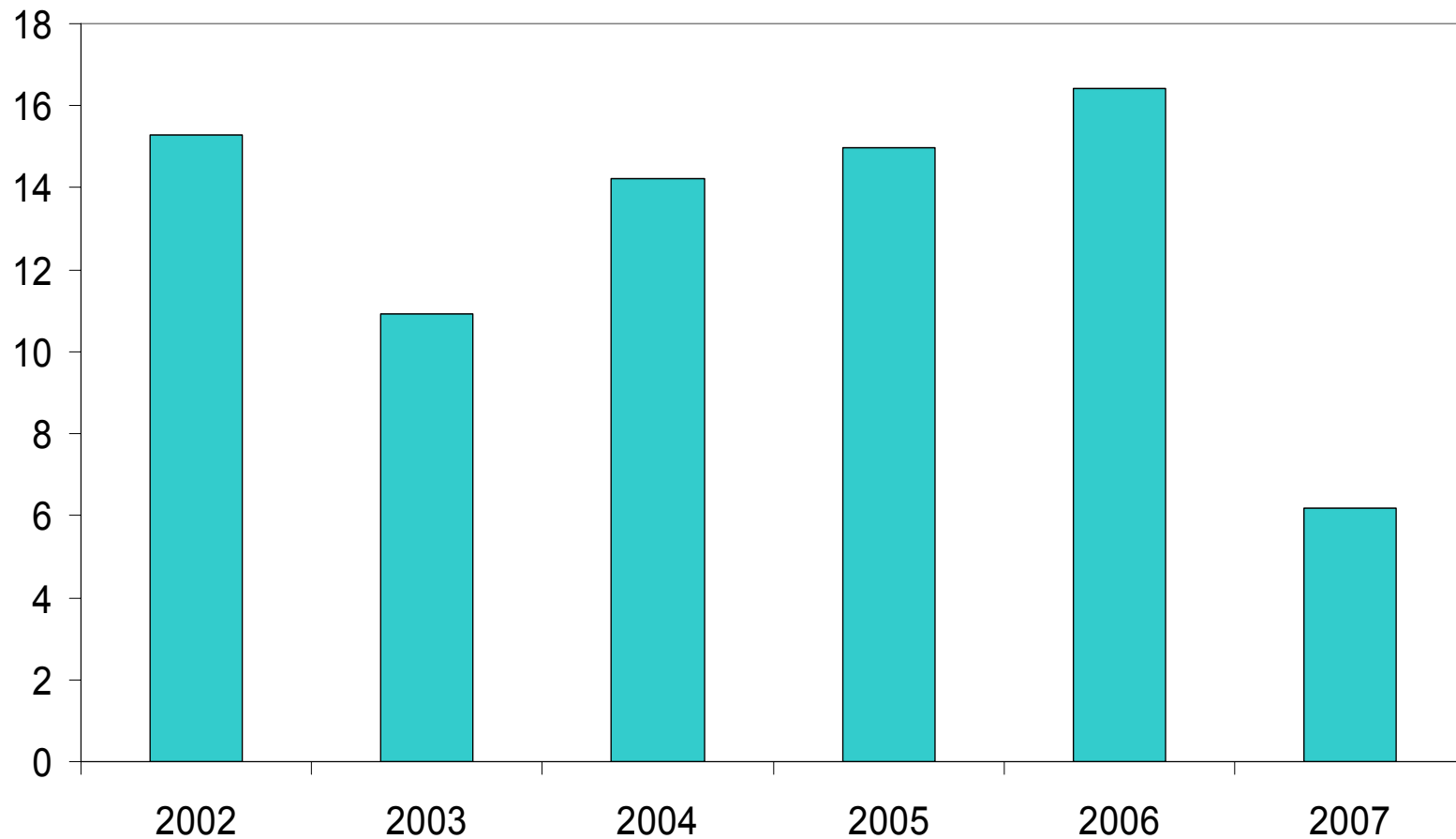
Structure of assets



# Return on assets have been relatively high



OFE average nominal rate of return (in percent)



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# Pending decisions and some future challenges



- Pending legal decisions:
  - tightening early retirement regulations
  - aligning the disability pension formula with DC scheme
  - defining annuity rules
- Main future challenge is to avoid poverty traps and related fiscal pressure:
  - increasing effective retirement age (mainly women)
  - promoting voluntary pension savings
  - broadening contribution base (self-employed)
- And...reforming the farmers' pension system