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

- 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)

Graph:
- % of GDP
- Government subsidy to SI
- Transition costs (FDC contribution)
15 years of reform experience

• 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

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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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