

# Polish Pension System

Subjects: **Others**

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Polish's Pension System was reformed in 1999. The new system is built from three parts. It comprises a public pension and an earnings-related system with notional accounts. There are also voluntary employer sponsored pension plans.

pension

adequacy

sustainability

replacement rate

## 1. Introduction

There are three most important aims of the pension system: adequacy, sustainability and integrity <sup>[1]</sup>. As adequacy, we consider pension benefits which allow one to prevent poverty and maintain the previous standard of life. Sustainability of the pension system is strongly connected with adequacy; thus, they both have to be balanced. In the Polish pension system, as a result of changes introduced by the government, the capital part keeps losing its important role.

For an individual, the most important thing is an adequate pension benefit <sup>[2]</sup>. Currently, the nominal average retirement pension in Poland is (data for March 2020) PLN 2395.11 (i.e., EUR 267.34 and PPP 1781.23—in 2017) and constitutes 44.92% of an average wage in the Polish economy. The amount of the lowest retirement pension, on the other hand, is PLN 1200 (EUR 1187.75). Thus, the amount of the average old-age pension is almost twice as high as the minimum subsistence level (PLN 1242.37), which means that it provides adequate living conditions. The minimum pension is slightly lower than the subsistence level, where the subsistence minimum is a social indicator measuring the cost of living of households. The scope and level of satisfied needs, according to this model, should provide such living conditions so as to enable the reproduction of life forces, the possession and upbringing of offspring and the maintenance of social bonds at each stage of human development.

## 2. Factors Affecting Polish Pension System

The level of pension benefit in Poland and, as a consequence, pension adequacy depends on various factors, especially on wages and seniority. These factors are currently subject to intensive changes due to flexibilization of employment history <sup>[3]</sup>. Flexible forms of work are associated with a lower salary and a shorter period of paying pension contributions. This will undoubtedly lead to a reduction in the level of pension benefits as well as problems with obtaining pension adequacy.

Fornero <sup>[4]</sup> considers the working career as the most relevant factor in determining the relative retirement income of women in comparison to men. According to Draxler <sup>[5]</sup>, this is connected mainly with changes in the level of wages, which constitute one of the most decisive factors in the level of pensions. Since “‘wage flexibility’ mainly means a larger spread of earnings at the lower end of the wage scale”<sup>[6]</sup>, pension benefits should be compared for workers with a range of different earning levels, for example, between 0.4 times and 3 times of the economy-wide average (Average Wage, AW). In this context, the situation of low-wage earners or people with career breaks needs to be particularly closely monitored <sup>[7]</sup>. Moreover, Hinrichs and Jessoula think that if pension systems were to be adapted to modified labor market conditions in time, they might not be able to either ensure adequate income maintenance or prevention of poverty, or both <sup>[8]</sup>.

There are very extensive reports on pension adequacy by the European Commission <sup>[7][8][9][10][11][12]</sup>. They contain a series of scenarios describing possible predicted values of the theoretical replacement rate. These scenarios, however, apply only to people with standard pension parameters. They do not consider any other retirement age than the standard one and do not explore a broader possible range of seniority. The 2015 and 2018 edition of the Pension Adequacy Report aimed at a multi-

dimensional approach to the adequacy of pensions. In this approach, three aspects of adequacy are considered: poverty protection, income maintenance, and pension duration.

The issue of pension adequacy is also discussed in OECD documents [13][14][15][16][17][18][19][20]. Research in this area is presented in the series Pension at a Glance. On the site <https://data.oecd.org/pension/gross-pension-replacement-rates.htm> it is given the value of Gross pension replacement rates calculated by OECD [21]. The Mercer reports [1][22][23][24], are widely known and include the ranking of pension systems in terms of adequacy, sustainability and integrity. Additionally, World Bank [25][26] conducts an analysis of retirement benefit adequacy. Scientific research in the field of measurement of pension adequacy is also carried out by Borella and Fornero [27] and Möhring [28]. They focus on the consequences of employment flexibility.

In Poland, the problem of pension adequacy is particularly dealt with in research by Chłoń-Domińczak [29][30][31]. Additionally, Chybalski [32] and Marcinkiewicz [33] take up the problem of adequacy, focusing primarily on the question of its measurement. Rutkowska-Góra [34] points to the adequacy aspects related to redistribution in the pension system. In Szarfenberg's [35] works, the aspect of adequacy in the context of poverty appears to be the most important. The problem of substitution between public pension wealth and private savings, which is connected with pension adequacy, is analyzed by Lachowska and Myck [36].

### 3. Conclusions

It is worth adding here that the Polish pension system is already financially inefficient and requires transfers from the state budget. According to the data of the Social Insurance Institution, in 2017, it amounted to nearly PLN 41 million, i.e., 19% of the total income of the Social Insurance Fund. However, in connection with the expected decrease in the level of self-generated pension benefits by system participants, a further increase in transfers can be expected. However, they will rather aim not at providing adequate pension benefits, but only at the payment of minimum pensions. Forecasts indicate that in the next five years, ensuring the solvency of pensions will require a subsidy in the amount of PLN 44 to 85 million, depending on the forecast variant.

In Poland, solutions aimed at co-financing the Social Insurance Fund from sources used in other countries, e.g., U.S., where in some states the pension funds are supplemented with revenues from airport or bridge taxes, are not being considered. It is possible that the need for such solutions will appear in the future due to the growing deficit of the Social Insurance Fund. Meanwhile, the financial resources needed for current retirement needs are derived from the Demographic Reserve Fund established in 1999 and supported by privatization funds and transfers from Open Pension Funds, which constitute the second pillar of the Polish pension system, and whose functioning is systematically limited.

In order to prevent poverty and maintain the pre-retirement standard of living, pensioners should have to make up for the difference in income from other sources, especially from the third pillar as well. Chłoń et al. [29] also emphasize the need to use additional sources of funding for the pension.

We should point out that the classification tree method can be successfully used for mining big databases, such as pension benefits. The decision tree and its rules provide descriptive information about the adequacy of future pensions. Classification trees help to assess the pension level in relationship to the changes in the earnings and breaks in the work career. Taking into account the factors such as the promotion of a salary during the career and wage variability, we may obtain precise rules which will help future pensioners with different career paths to make individual decisions in order to achieve adequate pensions.

It seems that there is a real need to continue to monitor an adequacy of pensions in relation to the level of earnings and the length of work career. This is especially important because of the fast increase in the labor market flexibility, which involves

changes in wages and changes in the level of pension benefits based on contributions to the system. This indication can be found also in previous studies <sup>[12]</sup>. In the pension adequacy research, it is necessary to include new variables, such as the number of children or marital status. For future studies of pension adequacy, the use of projected life tables is also recommended. It will take into account that people's life extends, which means that future benefits will be even lower than is now anticipated, and maintaining the adequacy of pensions will be even more difficult. The threat to the sustainability of the pension system will therefore be much greater. According to OECD <sup>[20]</sup>, against dealing with the challenges of ageing societies, working longer will be crucial to maintaining pension adequacy and financial sustainability. Next, it is worth examining pension adequacy in countries with different pension systems, while crucially differing in the level of state and market influences on pensions.

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