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Private pension funds in Poland

Abstract

This article takes a highly critical look at the pension system in Poland, which had been reformed after 1989 on the basis of the World Bank's 'three pillars' model of a combined state and private, mandatory and voluntary pensions system, despite evidence that the model is flawed and unobjective, being hinged on the inducements of cheaper credits for those countries adopting it. The author relates both the old and new pension systems in Poland, and describes the main problems which bedevil both – unemployment, low participation rates, an aging society and the migration of predominantly young and well-educated people. The extent of accumulated losses in privatised pension funds – in ironic contrast to what has been achieved by the state-run insurance society – as well as a degree of uncertainty over retirement ages generated by state activity threatens the insolvency and even collapse of the whole system. The article concludes with a brief look at fresh reforms proposed in 2011 aimed at reducing public expenditure but which appear to be at least partly politically opportunistic, as well as an outline proposal for a more sustainable pension system.

Keywords: *pensions, pay-as-you-go, privatisation, reform, unemployment, aging, migration, three pillars, inter-generational solidarity, under-funding, fees and commissions, productivity, re-nationalisation, pyramid schemes*

Introduction

A pension system is understood here as a superannuation or retirement system, i.e. a kind of arrangement (whether voluntary or not) between an insurer (a pension provider) and a customer (a future beneficiary), with the purpose of providing the customer (who is, when receiving a pension, called a pensioner or retiree) with an income when he or she will no longer be earning regular income from employment. Such systems may be set up by the state, employers, insurance companies, employer associations or employee associations, such as trade unions. From a technical point of view, retirement pensions are a kind of guaranteed life annuity, insuring against the 'risk' of longevity.

Until 1999, there was in force in Poland a pay-as-you-go pension system, based on agreement between the generations. In this system, the actual pension was calculated according to previous remuneration and the number of years of contribution. Such a model still prevails in developed countries. A pension calculated on this basis guaranteed an income in excess of 60 % of the remuneration received by the worker. According to the majority of orthodox experts,[1] equilibrium in this system is possible only if subsequent generations are relatively equal in size (or if the next generation is not

1 This is, of course, the monetarist and neo-liberal orthodoxy which prevails today.

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smaller than the previous one) so, in the case of demographic collapse (as observed now in Poland – see Tables 3 and 4 in this article), the financial equilibrium of the whole system becomes somewhat questionable.[2] However, such reasoning is flawed because it assumes *a priori* a constant productivity of labour but, when productivity is improved (which is an indisputable fact in developed and even in some developing economies), then greater revenue is generated by a smaller number of employees. This issue will be discussed in detail in this article.

According to Manuel Riesco, the 'manna' in the form of mandatory contributions is a fundamental cause of great interest in pension schemes to financial groups from around the world[3] while, according to Robin Blackburn:

> The greatest ambition of financial capitalism is to put its hand on the masses of workers' wages worldwide.[4]

In his article, Blackburn examines the role played by Larry Summers who, as chief economist of the World Bank, commissioned a study recommending the privatisation of pension systems in all developing countries.[5] This study was clearly incomplete and was certainly not an example of objectivity, but the privatisation of pensions, based on this study, flawed and full of errors as it was, has been carried out in many countries including, unfortunately, Poland.

What are the reasons for this? According to Blackburn,[6] the Summers report had strong support not only from the World Bank, but also from the International Monetary Fund (IMF) and from the Clinton administration, where Summers served as Secretary of the Treasury from 1995 to 2000. In this way, the governments of countries in which, as in Poland, so-called shock therapy had been introduced (Blackburn cites as examples Mexico, Kazakhstan and Nigeria) were strongly influenced to privatise their pension systems. Of course, any privatisation of pensions also means drastic cuts in the amount of retirement benefits paid by the state, a flow of taxes into private financial institutions and the 'consumption' of financial reserves by inflation which, in poorer countries, is often transformed into hyperinflation (such as in Zimbabwe and which, not long ago, was recorded in Turkey and Poland, not to mention Latin America). Despite this, the World Bank and the IMF explicitly encourage the further privatisation of pensions,

2 The recent publication of the Fédération Française des Sociétés d'Assurances (FFSA) also states that 'In a system based on pay-as-you-go, demographic changes significantly influence the future of pension systems' FFSA (2007) *Quel avenir pour la protection sociale?* March.

3 Riesco, M (2008) 'Upadłość funduszy emerytalnych w Argentynie i Chile' ('The bankruptcy of pension funds in Argentina and Chile') *Le Monde Diplomatique* (Polish ed.), December. See also, by the same author, *El fin de las AFJP* http://docs.google.com/View?docid=dhk3bd-nd_1473gc9vk4gp (27 January 2009).

4 Blackburn, R (2008) *The Global Drive to Commodify Pensions* https://sites.google.com/a/cendachile.cl/cenda/Home/publicaciones/autores/autores-invitados/blackburn--the [last accessed 13 March 2011].

5 Summers, L (1994) *Averting the old age crisis. Policies to protect the old and promote growth* New York: World Bank.

6 Blackburn, R (2008) *op. cit.*

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promising a better position in credit ratings and, thus, easier access to loans for countries who carry out the privatisation of their pension systems.

More powerful countries, such as the wealthier European countries and Brazil, escaped this transformation thanks to the strong resistance of public opinion. Despite this, the Buzek[7] government decided to privatise pensions in Poland, relying on the pseudo-scientific theories peddled by the supporters of abandoning the pay-as-you-go system and yielding to pressure from the World Bank, IMF and the American authorities. This privatisation was based on so-called Open Pension Funds.

According to Wikipedia, an Open Pension Fund (OFE, in the Polish) is:

> A legal person representing a distinct mass of assets, managed and represented by the general pension society.[8]

Open Pension Funds were created in 1999 to reform the old age benefits system and were supposed to allow for the collection of the financial assets of future pensioners in the so-called Second Pillar.[9] According to the same source, people belonging to OFE hold units giving them formal title to part of the Fund's assets. There are currently fifteen pension funds operating in Poland (initially, there were 22). This system is, at present, mandatory for people who are subject to social insurance and were born after 31 December 1968. The new system also embraces people born before that date and after 31 December 1948 who are able to choose whether they want to remain in the First Pillar (the state-owned ZUS) or go to the new system. People born before 1 January 1949 receive a pension determined in accordance with the rules established before the reform, i.e. by a system based on redistribution on the basis of a solidarity contract between the generations.

Out of the funds paid to the OFE, pension companies charge a fee that depends on the amount of contributions and on the value of assets (the management fee amounts

7 Buzek is now, partly due to his service to international financiers, the President of the European Parliament.

8 http://pl.wikipedia.org/wiki/Otwarty_fundusz_emerytalny [last accessed 13 January 2009].

9 According to Wikipedia (http://pl.wikipedia.org/wiki/Emerytura) [last accessed 13 January 2009], retirement in Poland is granted to people who have reached retirement age (sixty years for women and 65 for men) and have documented the requisite period of employment. This applies, however, only to the so-called old pension system and thus to people who were born before 1949; in the new system, the importance of seniority is negligible since all that is required is the appropriate level of an individual pension account. In other words, retirement benefit depends in the new system mostly on the amount of capital accumulated in the appropriate account. The present-day Polish pension system is divided into the so-called 'three pillar' system: *the First Pillar*, operated by the State Social Insurance Institution (ZUS); *the Second Pillar*, serviced by private pension funds (OFE); and *the Third Pillar*, consisting of individual retirement accounts (IKE) and employee pension plans (PPE). The First and Second Pillars are mandatory, while the Third Pillar is voluntary.

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to 0.6 % per year).[10] Funds accumulated in the OFE can be (at least in theory) inherited up to the moment of retirement of the contributor. There is at present no final resolution, but it is most likely that these will not be the subject of inheritance from the point of retirement, similar to funds which belong to the First Pillar.

The old (pre-1999) pension system in Poland

Up to 1999, the Polish pension system required both employer and employee to contribute money to a state fund (managed by ZUS – Zakład Ubezpieczeń Społecznych)[11] during their employment in order to receive defined benefits upon retirement. It was an example of a system based on contribution-based benefits, with the amount of pension dependent on an individual's contribution history. Such a system should be differentiated from a social pension system that pays regular, tax-funded, non-contributory cash transfers to older people, based only on their citizenship and/or residence period and which is not dependent on previous contributions, for example in the form of personal income tax.[12] It was, thus, a kind of traditional defined benefit plan, i.e. a plan in which the benefit on retirement was determined by a set formula, rather than dependent on the returns on investment made by the provider of the pension. Such a procedure, for example the one used by ZUS, links the amount of pension to such factors as salary (or wage) history, length of employment, age at retirement, and some other factors via a rather complicated and not particularly transparent formula. Those pensions were, as a rule, indexed by inflation so they provided a regular, guaranteed (although usually rather modest) stream of income for pensioners.

The general design of the 'old' Polish pensions system was based on Chancellor Otto von Bismarck's social legislation, namely the Old Age and Disability Insurance Bill which was enacted in Prussian-run Germany in 1889. That old age pension programme was financed by a tax on workers and was originally designed to provide a pension annuity for workers who reached the age of seventy (it was lowered to 65 in 1916). It is now claimed by critics of the ZUS-based pension system that, at the time of Bismarck, life expectancy for the average German was only 45 years; but this figure ignores the extremely high infant mortality in 19th century Germany[13] and the high maternal death rate from childbirth in this era. The truth is that an adult German entering into von Bismarck's insurance scheme would, on average, live to seventy years of age, a figure that was used in the actuarial assumptions included in von Bismarck's legislation.

From a purely technical point of view, the old (ZUS-based) pension system was a funded defined benefit pension system, as it was supposed to be paid from a kind of

10 The distribution fee, or provision, collected by the OFE from each mandatory contribution was, or is scheduled, as follows: to the end of 2010 – max. 7 %; to the end of 2011 – max. 6.125 %; to the end of 2012 – max. 5.25 %; to the end of 2013 – max. 4.375 %; after 2014 – max. 3.5 %.

11 Literally 'Social Insurance Institution', i.e. the State Pension Fund, or State Pensions Institute.

12 Presently, over eighty countries have such social pensions – for example Australia, Canada and New Zealand.

13 Even in 1950, this was as high as 50 deaths per 1 000 births, compared to today's relatively low 3.5.

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Pensions Reserve Fund, or Social Security Reserve Fund, managed by ZUS. Thus, obligatory retirement contributions were invested in a fund managed by ZUS, with the purpose of meeting the benefits paid out by the ZUS. This means that, in that system, investment risk was typically assumed by ZUS, i.e. by the state. The first problems occurred when ZUS started to be insufficiently funded, so it did not have enough financial resources to continue funding the plan, when additional taxpayers' money had to be used.

According to ZUS,[14] its deficit will, between 2009 and 2013, be at least 217 billion Polish złotys (PLN) i.e. approximately €55bn (and, in the worst case scenario, up to as much as PLN 333bn, or €83bn). These losses have to be covered by the budget via taxes and loans (public debt). The main cause of this underfunding is the extremely high level of unemployment in Poland (see Table 1) which, during the decade between 1990 and 2010, was always above one million people and in only two years (1990 and 2008) was it below 10 %. The other factor is that this high, structural and chronic (persistent) unemployment has translated itself both into mass migration from Poland (between one and three million in this century alone, depending on the source – see Table 2), as well as into low participation rates: presently, only 55 % of Poles of productive age are in work and, for the 55-64 age group, only 28 % are working – this is the worst result in the whole of the EU. It is indeed mostly caused by the very high levels of unemployment: older workers are being 'pushed out' of employment and the labour market.

Table 1 – Unemployment in Poland, 1989-2010

Year	Number of Unemployed (000)	Unemployment Rate (%)
1989	201	1.17
1990	1 126	6.38
1991	2 156	11.80
1992	2 509	13.63
1993	2 890	15.44
1994	2 838	15.66
1995	2 690	15.10
1995	2 629	14.90
1996	2 360	13.60
1997	1 826	10.90
1998	1 831	10.40

14 Cashflow.com (nd) *ZUS będzie miał gigantyczny deficyt w latach 2009-2013* available at: http://www.cashflow.com.pl/?p=/pl/3/150 [last accessed 26 March 2011].

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1999	2 350	13.40
2000	2 785	16.40
2001	3 115	18.50
2002	3 431	19.90
2003	3 329	19.60
2004	3 230	19.10
2005	3 020	15.80
2006	2 867	14.00
2007	2 332	12.80
2008	1 779	9.40
2009	1 893	12.01
2010	2 070	12.90

Sources: own estimates, based on data from EUROSTAT, GUS, ILO and OECD.

One other reason for the high deficit of ZUS is the aging of Polish society, caused mostly by low birth rates – again, in general, a result of high unemployment, Poles are now reluctant to have children because of the high risk of losing their job and, thus, a main source of income (see Tables 3 and 4). This, coupled with a general lack of effective support for families, such as the non-existence of affordable housing, an insufficient number of kindergartens and ridiculously low family benefits, have created a situation in which fewer and fewer workers must support higher and higher numbers of people unable to work either because of old age or because of the lack of employment opportunities. At the moment, due to high unemployment, low participation rates, migration and the aging of the population, there are four workers for every retired person but, if present trends are extended into the future, there could be a situation when Poland has more pensioners and unemployed people than workers.

Table 2 – Emigration from Poland, 2001-2010

Source	**Year of estimate**	**Number of emigrants to the EU**	**Number of emigrants to Germany**	**Number of emigrants to the UK**	**Number of emigrants to Ireland**
Official British Census	2001			61 000	
Bijak & Koryś	2002	20 000	18 000		
Maniak & Lewandowska	2004	1 150 00	683 400	169 700	80 000
Polish Ministry of Economy	2004	507 000		48 000	

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GUS[a)]	2005	90 000	75 000	4 000	500
Maniak & Lewandowska	2005			205 000	
Catholic Church (Poland)	2006	1 000 000			
ECAS[b)]	2006	1 120 000			
Kaczmarczyk & Okólski	2006			209 000	
Kłos	2006	1 200 000	535 000	264 000	100 000
Polish Ministry of Labour	2006	660 000			
UK ONS[c)]	2006			406 000	
Various Polish media[d)]	2006	3 000 000			
World Bank	2007	1 860 000		690 000	
GUS[a)]	2008	164 000	113 000	23 000	5 000
ONS (UK)	2010			515 000	
Wikipedia[e)]	2010			1 000 000	

a) Polish Central Statistical Office

b) European Citizen Action Service

c) UK Office for National Statistics

d) i.e. between 2 000 000 and 4 000 000

e) http://en.wikipedia.org/wiki/Polish_migration_to_the_United_Kingdom [last accessed 21 March 2011]

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Maniak, G and R. Nowak-Lewandowska (2006) 'Wybrane aspekty emigracji zarobkowych i ich konsekwencje dla rynku pracy w Polsce po 1 maja 2004 roku' ('Selected Aspects of Economic Emigration and its Consequences for the Labour Market in Poland after 1 May 2004') in: D. Kopycińska (Ed.) Bezrobocie we współczesnych gospodarkach rynkowych (Unemployment in Contemporary Market Economies) Szczecin: Szczecin University (Project LAMA)

UK Office for National Statistics (2008) International Migration 2006 Data http://www.statistics.gov.uk/downloads/theme_population/MN33.pdf [last accessed 22 March 2011].

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From an orthodox point of view, the main challenge to traditional pension systems is the aging of the population: dropping birth rates and increasing life expectancy sees an ever-larger portion of the population becoming elderly and leaving fewer workers for each pensioner. Nevertheless, increases in productivity caused by technological progress and better work organisation are not taken into consideration by orthodox economists, who erroneously claim in almost all developed countries that this aging of the population means that government and public sector pensions could collapse their economies unless pension systems are reformed and/or taxes increased. One of the orthodox methods of reforming the pension system is thus increasing the age of retirement (even in countries with high levels of unemployment), as was recently done in France,[15] or privatising pension systems, since the increase of taxes is not compatible with present-day ruling neo-liberal and monetarist orthodoxy.

From a purely technical point of view, it can be said that the designs of traditional defined benefit plans tend to exhibit a J-shaped pattern of benefits accrual,[16] where the present value of benefits grows quite slowly in the earlier part of an employee's career and accelerates significantly only from mid-career. In other words, it costs more to fund a pension for older employees than for younger ones – a so-called 'age bias'. ZUS pays benefits as an annuity, so Polish pensioners do not bear the risk of low investment returns on their contributions, or of outliving their retirement income. The open-ended nature of these risks to the state is, therefore, one of the reasons for seeking a switch from this defined benefit arrangement to defined contribution plans based on private retirement funds.[17]

Table 3 – Natural increase in population (per 1 000 inhabitants) in selected countries and regions, 1950-2006

Country	1950	1960	1970	1980	1985	1990	1995	2000	2001	2004	2006
Australia	13.7	13.8	11.6	7.9	10.4	8.4	7.3	6.3	6.0	9.0	6.1
China (PRC)	21.0	20.0	19.0	17.0	12.0	11.1	11.5	9.2	6.0	5.7	5.9
EU						4.4	2.4	3.1	3.6	5.1	
Germany				-1.1	-0.2	-0.1	-1.4	-0.9	-1.1	0.0	-1.8
Germany: East (GDR)	*4.6*	*3.4*	*-0.2*	*0.4*	*-0.1*	*-0.4*					
Germany: West (FRG)	*5.9*	*6.4*	*1.3*	*-1.5*	*-0.2*	*-0.2*					

15 The exceptions are supposed to Australia and Canada, where the pension system is forecast to be solvent, at least for the foreseeable future. However, these two countries have an advantage in their relative openness to immigration and huge natural resources, coupled with a relatively small population – but, otherwise, they have rather low birth rates.

16 This is a result of their typically flat accrual rate and the decreasing period needed for interest discounting as people get closer to the age of retirement.

17 Otwarte Fundusze Emerytalne – literally 'Open Pension Funds', managed by PTE (Powszechne Towarzystwa Emerytalne – General Pension Societies).

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Japan	17.3	9.6	12.0	7.5	7.0	3.2	2.2	1.8	0.3	0.1	0.6
Poland	**19.1**	**15.0**	**8.5**	**9.6**	**7.9**	**4.1**	**1.2**	**0.3**	**0.1**	**0.0**	**0.1**
UK	4.5	6.0	4.5	1.5	-0.1	2.7	1.5	1.2	0.4	2.9	4.1
USA	13.9	14.2	8.9	7.1	10.0	8.0	6.0	5.5	3.7	9.2	5.8

Sources: own estimates, based on EUROSTAT, GUS, ILO and OECD official data

Table 4 – Average natural increase in population (per 1 000 inhabitants) in selected countries, 1901-2015

Country	**1901-1910**	**1920-1924**	**1935-1939**	**1930-1938**	**1950-1960**	**1960-1970**	**1970-1980**
Australia	15.8	14.6	7.6	7.9	2.3	2.0	1.6
China[c)]			10.0		1.7	2.4	1.8
Germany	14.2	9.2	7.5	7.5	0.6	0.7	0.1
Japan	11.5	12.0	11.8	11.8	1.2	1.0	1.1
Poland	**17.1**	**13.6**	**11.2**	**10.7**	**1.8**	**1.0**	**0.9**
UK	11.5	9.2	3.1	3.1	0.3	0.6	0.1
USA		10.8	6.0	7.6	1.7	1.3	1.1

Country	**1975-1999**	**1980-1990**	**1986-1991**	**1990-1997**	**1990-2010a**	**2000-2015b**	**2001-2005b**
Australia	1.3	1.4	1.6	1.2	1.0	0.9	1.1
China[c)]	1.3	1.3	1.8	0.9	1.1	0.7	0.6
Germany	0.2	0.1	0.4	0.5	-0.1	-0.1	0.1
Japan	0.5	0.6	0.4	0.3	0.3	0.0	0.1
Poland	**0.5**	**0.8**	**0.4**	**0.1**	**0.5**	**-0.1**	**-0.1**
UK	0.2	0.2	0.3	0.3	-0.2	0.1	0.4
USA	1.0	0.9	0.9	1.0	0.6	0.8	

a) UN prognosis from 1990

b) UN prognosis from 2000

c) PRC since 1949

Sources: own estimates, based on EUROSTAT, GUS, ILO, OECD and League of Nations official data

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Present-day pension system in Poland

In present day Poland, retirement is achieved at the age of sixty years for women and 65 for men. People who have reached retirement age and have documented the requisite period of employment,[18] or those who have achieved the minimum age of retirement,[19] are entitled to retirement benefits. However, in 1999, the result of the pressure applied by such institutions as the IMF and the World Bank was that pensions reform was implemented in Poland, as was explained above. Subsequent to the reform, there are three so-called pillars which make up the pension scheme in Poland.

The First Pillar

This is now officially an individual account managed by ZUS and is compulsory for all employees. Pensions in the First Pillar are based on a distributional system which has the character of an inter-generational agreement, meaning that pensions are financed from the contributions of people currently working. Those contributions are added to individual accounts but are not invested and do not earn any returns since they are automatically paid out to current pensioners. They are also not inherited in the case of death.

The Second Pillar

This is a funded defined contribution scheme based on 'Open Pension Funds' that are, in general, available to people born after 31 December 1948[20] and are managed by private, usually foreign, companies. For people forced to participate in the Open Pension Fund, contributions to the pension plan are 19.52 % of gross income and are, in part, counted in the individual account handled by ZUS (12.22 %), with the rest (7.3 %) transferred from ZUS to the Open Pension Fund allocated to the employee and which holds the contributions in the individual's own account. Money collected by the OFE will be paid to a customer only after reaching retirement age. An insured person forced to participate in this scheme can, in theory, choose the pension fund in which the funds are invested. In these funds, there is the so-called individual capital which is invested by the selected Open Pension Fund. Contributions paid to the second pillar are exempt from income tax and (in a rather restricted way) they can be inherited (at least in theory) by the close relatives of the insured party in the case of his or her death.

The Third Pillar

This consists of so-called individual retirement accounts (IKE – Indywidualne Konta Emerytalne) and is a part of the pension scheme which can be joined at almost any time. Individual retirement accounts are 100 % voluntary and supplement the First and Second Pillars of the pension system explored above. The manner of managing

18 For the old pension system, mandatory for people born before 1949.

19 For the new pension system, mandatory for people born after 31 December 1948.

20 This system is compulsory for people born after 1 January 1969 (people born before 1969 are allowed to participate in this scheme on a voluntary basis). If a person born after 1 January 1969 does not choose an Open Pension Fund, he or she is randomly assigned to one of the funds.

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contributions in this Pillar can be different and (at least in theory) an account holder is free to decide in this area. The gains from such savings accounts are exempt from taxes on capital gains, which are now 19 % in Poland,[21] but only if withdrawal is made after reaching retirement age.

In theory, under the new system, the level of post-retirement benefits will depend mostly on how much money a person manages to collect in the second and third pillars. In the new system, the number of years worked is not important. However, a minimum level of deposit is required in the individual account. In other words, the future pension depends on the amount of capital accumulated throughout the entire period of a person's working life. According to the new principles, the accounting base for calculating the pension is the resources gathered in the first and second pillars from 1 January 1999.

Problems with the Second Pillar

Funded defined contribution (FDC) schemes (or Open Pension Funds) were created in Poland in 1999. In this system, 37.4 % of the pension contribution is redirected to the FDC while the rest remains in the public notional defined contribution (NDC) system. The FDC share of the contribution is relatively high compared to other countries with similar systems, especially given the currently high structural deficit in the NDC system in Poland.[22] In 2010, roughly 1.6 % of Poland's GDP was transferred to the FDC, bringing the total value of transfers (including the cost of financing) to 16.5 % of GDP, and this cost was fully covered by the state budget.

However, the magnitude of the transfer begs the question as to its limits and to the temporal structure. The transition period during which the accumulation of assets in the FDC is taking place is still far from over. Only those people who were born after 1968 are obliged to join the FDC, which implies that disbursements from the new system will remain insignificant until at least 2030. Thus, in order to estimate the impact of the new system on the balance of public funds, it is necessary to take into account the loss of pension contributions from, as well as the lower future pensions paid by, the public NDC (ZUS) system. According to simulations made by Kempa,[23] the FDC will incur a small cost even at the end of 2060 (the analysis horizon). However, if the cost of finance is included then, by 2060, the accumulated cost of transfers to the FDC will reach to as much as 94 % of GDP.

So far, the criticism of the new pension system has been based mainly on the lack of specification in the rules as regards whether that part of the pension coming from private pension funds (OFE) will be paid directly by those funds or via the state-controlled ZUS. There have also been concerns – which still exist – relating to the partial restoration by subsequent governments of the right to early retirement for certain occupational groups (such as miners, policemen and military personnel) as well as the maintenance, contrary to initial assumptions, of separate pension schemes for uni-

21 The so-called Belka tax, after the former Polish Minister of Finance and Prime Minister.

22 Kempa, M (2010) *What is the cost of funded pension scheme in Poland?* Warszawa: Ministerstwo Finansów, available at: http://www.mf.gov.pl/dokument.php?const=1&dzial=2911&id=227003 [last accessed 26 March 2011].

23 *ibid.*

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formed employees of the state (mainly, the military and the police). Hence, according to some circles, this breach of the regulations may result in the insolvency and collapse of the whole system, which had been constructed under the assumption of the equality of all occupational groups concerning rights and obligations under the pension regulations.

However, the main reason for the expected collapse and insolvency of the new pension system is quite different. In short, it is because this system generates only fiat (nominal) money since, in the current financial system, money has practically no inherent value while its purchasing power changes rapidly in time (mostly due to inflation). Hence it may happen, and even in the near future, that the nominal pensions paid by the Second and Third Pillars will not be able to provide a degree of maintenance, even at the subsistence level, which will require the state to pay additional pensions from its current revenue (or loans).

An additional problem is also the solvency of the private pension funds. They have been criticised for their greed, impunity and an apparent inability to learn from their mistakes. The scale of the problem existing here is large, for it represents a capture of some PLN 10bn, or about 7 % of the PLN 150bn in contributions collected (via ZUS) as part of the Second Pillar. So, from the perspective of future pensioners, it is no longer a pillar, only a shaky scaffolding, and there is a growing voice in Poland on the need for additional private insurance for old age (e.g. saving in the so-called Third Pillar, namely in individual retirement accounts).

However, knowing Polish realities, one can safely assume that, in just a few years time, we will have the concept of a fourth and perhaps even a fifth 'leg' of the pension system. Meanwhile, 'experts' on pensions (whose increasing number does not imply any improvement in their quality) say that the current billions in losses incurred by the private pension funds are simply so-called 'temporary' and 'transient' disturbances – concepts that are so well-known to the older generations – that will be fixed by the boom years to come. However, it is only an apparent explanation as, not knowing the future, we have no certainty at all as regards the possibility of making up these losses and the sequences of 'booms' and 'slumps' known from the past may not necessarily be repeated in the future.

What is more: the time horizon of the current crisis is moving ever forward. Hence, Argentina and Hungary have re-nationalised their pension funds, fearing that 'they will disappear up their own ends'. In addition, Argentina has plenty of experience in this regard, as it has already, more than once, been on the verge of bankruptcy and did not want to repeat its previous mistakes. Meanwhile, in Poland, the losses of private pension funds reached over 20 % of their deposits in 2008. From early 2000 until the end of 2008, the rate of return for Generali, the best of the Open Pension Funds, amounted to 28.6 % but, at the same time, capital accumulated in the ZUS (First Pillar) increased by up to 39.6 %.[24] Thus, if since 1999, the same amount of money had been directed to an Open Pension Fund (OFE) and to the Social Insurance Institution (ZUS), a person

24 Czarkowski, M (2009) 'ZUS kasuje OFE. I po co nam była reforma emerytalna' *Trybuna* 10-11 January.

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earning the national average wage would have about PLN 600 more in the ZUS account than in the best private pension fund.

In other words, according to Marek Czarkowski:

> ... that taunted, kicked and scorned communist relic earned nearly twice as much for future pensioners than the vibrant, dynamic young wolves of liberalism! However, there is nothing surprising in this. The idea of the Buzek government, based on directing the savings of future pensioners to the stock exchange, has been ill since the beginning. Nevertheless, it was very attractive to the private, usually foreign, owners of the pension funds. The law, adopted by the Polish parliament, guaranteed them profits (by courtesy of so-called fees) amounting to 7 %. The owners of pension funds were so keen to collect these vanities, that [in 2009] alone, due to these mandatory charges, they received somewhere between 1.5 and 1.7 billion zlotys in a situation in which well over 20 billions of our savings 'evaporated' because of wrong (mismatched) deals.[25]

The situation with ZUS is completely different. This institution, wrongly called by liberals 'a relic of times past' and often serving as the standard bearer for extreme wastefulness and unbridled consumption by bureaucrats at the expense of citizens, has been an extremely effective and, most importantly, very safe machine to 'make money' because ZUS has invested predominantly in Treasury Bonds which, by definition, at least bring nominal profits. However, the general pension societies (PTEs) that were managing the money collected by future pensioners in the Open Pension Funds were speculating on the stock market without taking into account the inevitable financial crisis which brought them over 20 billion in losses.

Unfortunately, at least so far, this has not changed the mindsets of the promoters of this infamous 'reform of pensions'. Just like ten years ago, they are today trying again to convince us that, in the so-called 'long term', these pension funds will bring profits while forgetting that, quite a long time ago, J. M. Keynes said that, in the 'long term', we will all be dead. Czarkowski reminds us that:[26]

> The so-called Second Pillar provides future pensioners only with an opportunity to get rid of their money. This design, similar in my opinion to financial pyramid schemes, works under the full majesty of the law, under the protection of the public authorities and subject to their rituals, the observance of which ensures the involvement of the fittingly named Financial Supervision Commission.

Recent changes in the Polish pension system

The present day (i.e. in 2011) right-wing liberal government of Poland, led by Civic Platform, faces increasing problems in maintaining the level of public debt below the arbitrarily-set level of 55 % of Poland's GDP. It was one of the reasons why it has proposed several changes aimed at reducing public expenditure, including that on old age pensions. The Polish government has thus gone back on its earlier proposals to

25 *ibid.*
26 *ibid.*

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redirect a larger part of contributions from private funds to the state-owned ZUS. On 24 January 2011, Prime Minister Donald Tusk's Chief Economic Advisor, Michał Boni,[27] presented a new government proposal to improve the pension system in Poland. The proposal contained such elements as:[28]

- decreasing the share of workers' income compulsorily redirected to private funds from 7.3 % to 2.3 %, with the other 5 % redirected to special individual accounts held by ZUS
- those individual accounts will remain independent of the state-owned Social Insurance Fund and the contributions transferred to individual accounts held by ZUS would be indexed according to the average growth rate of nominal GDP over the last five years[29]
- investment limits in the stock market for private funds would be gradually increased so that, in 2020, private funds would be allowed to invest up to 62 % of their assets on the stock market instead of the current 40 %, thus seriously increasing the risk of total loss
- the money collected in individual accounts held by ZUS could be inherited by a designated beneficiary and transferred to their individual ZUS account while, in the case of divorce or separation, that money would be divided between beneficiaries
- some tax incentives would be offered to those who decided to save in individual pension accounts (the so-called Third Pillar of the system) – this tax relief would amount to 2 % of salary in 2012 increasing to 4 % in 2017.

In this way, the present Polish government hopes that this reform would reduce the public debt of Poland by approximately €59 billion ($83bn, which is equivalent to roughly 18 % of the 2010 GDP of Poland). However, this optimistic expectation has been strongly criticised by employer organisations, such as the Polish Confederation of Private Employers 'Leviathan' (PKPP Lewiatan), the Business Centre Club and Employers of Poland (Pracodawcy RP). These organisations, because of their narrow egotistical interests, oppose the reduction of transfers to the private sector, seeing this as an attempt drastically to weaken or even demolish the Second Pillar of the system. Instead, those organisations representing the interests of private capital propose unspecified reforms to private pension funds which would lower the cost of their operations and increase their efficiency.

These reforms have also been strongly criticised by the trade unions, such as the Independent and Self-Governing Trade Union 'Solidarity' (NSZZ 'Solidarność'),[30]

27 A former informant ('mole') of the communist secret police: http://pl.wikipedia.org/wiki/Michał_Boni [last accessed 26 March 2011).

28 Mrozowicki, A (2011) *Government proposals for pension system reforms continue to spark controversy* available at: http://www.eurofound.europa.eu/eiro/2011/02/articles/pl1102019i.htm?utm_source=EIRO&utm_medium=RSS&utm_campaign=RSS [last accessed 26 March 2011].

29 It is assumed that, from 2013, the proportion of money transferred to private funds would grow and reach its maximum (3.5 %) in 2017.

30 Now only a pale shadow of the 'Solidarity' of the early 1980s.

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which suggested that these reforms would only serve the short-term interests of the state, hiding public debt by shifting it into the First Pillar of the system and postponing urgently needed, more fundamental, reforms. Other trade unions, such as the 'post-communist' All-Poland Alliance of Trade Unions (OPZZ) argued that employees should be free to choose where their contributions to the Second Pillar of the system go; that is, whether to the state-run ZUS or to the private, mostly foreign-owned funds.

It is thus clear that the current pension system requires urgent reform in order to keep it sustainable in the long term. However, the government proposal to shift part of the contributions from the private to the state sector can be criticised for its half-way house measures as well as for its poorly disguised short-term attempt to hide the real problems of the Polish economy, such as industrial and demographic collapse, mass and structural unemployment, widespread poverty and the large-scale exodus of (mostly young and well-educated) Poles from Poland. The government has proved rather reluctant to take the alternative proposals and criticisms of the opposition seriously, so it is very likely that these present reforms to the Polish pension system will generate further social tensions and further economic problems even in the very near future.

Conclusion

The truth is thus that the private owners of pension funds (OFEs) and their lobbyists depend on the existence of these compulsory fees and commissions (initially 7 %, with a view to a minimum 3.5 %), so it is in their best interests that these fees are maintained as long as possible. In 2008 alone, these funds have lost a total of PLN 22bn, while the actual increase in the value of retirement accounts, after deducting management expenses, is lower than if they were stored in an ordinary bank deposit account.[31]

OFE owners assume that, one day, this system may collapse, as did the pyramids of Ponzi and Madoff, and just as how, at the end of 2008, a similar pension system in Argentina also collapsed which had, in 1998, been a model for the Polish 'reformers' of the team of Balcerowicz and Buzek.[32] That ZUS has shown ability, earning in the last ten years more than the private pension funds, should not be surprising since, from the time of Chancellor Bismarck, there has not been invented anything better than the state-owned, fair, prudent and competent company dedicated to pensioners, financing old age pensions mainly from the current, and thus real, incomes of the state. Private pension funds pay only nominal pensions so how much those pensions are worth in real terms (i.e. in the goods and services needed by pensioners), will determine only the future state of the real economy. Therefore, the amount of our retirement benefits will depend in the final instance on the real productivity of our children, not on how and where our nominal (financial) contributions have been invested.

The only realistic solution seems, therefore, to be an introduction of the dependence of old age pensions on the current capacity of the real economy, while ensuring that the level of pensions accords at least with a socially-acceptable minimum (such as the minimum wage). This should be done in conjunction with the financing of those pensions directly from the budget, and therefore directly from taxes, without the need to

31 Zalewski, G (2009) 'Moja symulacja OFE' *Bossa.pl* 12 March 2009.

32 Czarkowski (2009) *op. cit.*

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maintain both ZUS and OFEs (private pension funds), with their bloated and costly bureaucracies. Of course, if someone wants to save more for their old age, he or she could do so but only at his or her own risk, or by way of saving in a special 'old age pension' bank account (similar to the present Third Pillar), which would have a guaranteed nominal rate of interest fixed at least to a level equal to the actual rate of inflation rate plus, say, one percentage point, and that this interest would not be taxed if the money from this account were not withdrawn before reaching the statutory retirement age.

Finally, it should be noted that, as early as 1990, J. K. Galbraith[33] was warning against pursuing the American model of capitalism in eastern Europe, but his wise advice has, unfortunately, been completely disregarded in Poland. Therefore, the only logical step that an inhabitant of Poland can now take in order to improve her or his lot, is to emigrate. However, jobs are also in short supply in the recession-ridden west, so immigrants from Poland need to be prepared for an unpleasant and even hostile reception in the rich west unless they are ready to accept the worst jobs in the secondary, i.e. inferior, segment of the labour market – usually, so-called '3D' jobs (difficult, dirty and dangerous).

This, coupled with general uncertainty in the area of old age pensions, is definitely not the kind of future that was promised to Poles in the early 1990s, during the first 'free' elections to the Polish Diet, by such activists of the anti-communist 'Solidarity' movement like, for example, Lech Wałęsa, Tadeusz Mazowiecki, Adam Michnik, Jacek Kuroń and, last but not least, Leszek Balcerowicz.[34]

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