

Pension system and employment incentives – Polish experience

Age of the withdrawal from the labour market in Poland belongs to the one of the lowest among the OECD countries. This outcome is the inheritance of the pre-transition pension system that was offering a wide scale of early retirement privileges addressed to various occupational groups. In particular, early retirement pensions were granted to the miners, railway workers and teachers as well as people working in the so-called special conditions or special character. The list of such professions was included in the decree of the Council of Ministers from 1983 that included a couple of hundreds of professions, who could receive such early retirement benefit.

Upon the economic transition, additional options for early retirement were granted to people that were laid off from their companies. At that time, the disability assessment procedures were also relatively weak. The aim of such policy was to absorb the excess labour supply of people with relatively low human capital that had lower chances to find employment in rapidly changing economy.

As a result of these policies, the number of pension beneficiaries increased drastically, leading to the increase of total pension expenditure. This, in turn, resulted in the increase of social security contribution and increased tax wedge. In 1991, the number of new old-age and disability pensions granted peaked at 815 thousand persons. For comparison, in 2006, the number of new old-age and disability pensions was by 80 per cent lower (154 thousand). Between 1991 and 2006 the number of new pensions was gradually decreasing, which was the result of finalisation of the main wave of the restructuring process.

In 1998 the option for early retirement due to lay off from the company was discontinued. However, new types of pre-retirement benefits were introduced. As a result, there was no reduction of the number of people that were retiring early. On the contrary, the reduction in the number of people receiving early old-age pensions was substituted by the increase in the number of people receiving pre-retirement benefits and allowances. Between 1997 and 2004 the number of people below retirement age receiving various type of long-term benefits was increasing. This was accompanied by the drop of the employment rate for people aged 55-64.

The pension system reform of 1999 eliminated options for early retirement in the mandatory pension system, which means that those covered by the new pension system (those born after 1948) will not be able to retire below legal retirement age (60 for women and 65 for men).¹ All people born before 1949 still can exercise their early retirement options as these existed in 1998. This means that the change in retirement behaviour and potential extension of working lives in Poland can be expected after 2009, when first cohorts covered by the new pension system will retire. Such policy choice was helpful in convincing the public opinion to the principles of the new pension system, as those close to retirement age were assured that they could retire as they already planned. Yet, it has significant consequences on the labour market, as the employment rate of older workers in Poland is kept on the very low level (one of the lowest in the EU member states).

¹ With exception of those that could use the transition rules allowing people to retire early before the end of 2007. Initially, the transition period was planned until the end of 2006, but it was extended by the Parliament in 2005.

Figure 1. Number of newly granted pensions (old-age and disability)

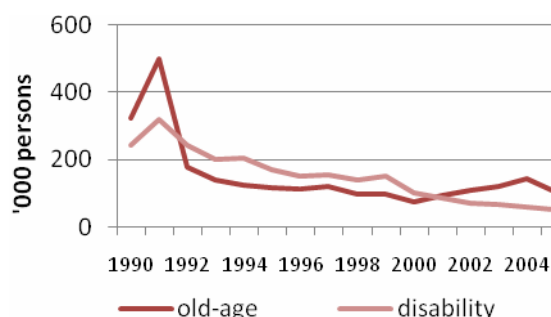
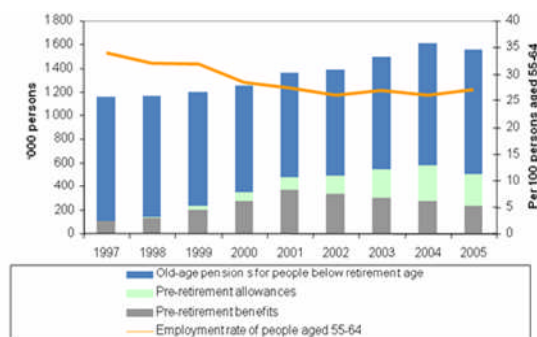


Figure 2. Number of people receiving old-age pensions and pre-retirement benefits below retirement age



Source: Social Security Administration (ZUS), Ministry of Labour and Social Policy (MPiPS)

As a result of existing options of early retirement, the average age of taking up the old-age pensions is significantly lower than the legal retirement age both for men and women. As it is illustrated in Figure 3, average retirement age in Poland evolved over the past 16 years. At the beginning of 1990s it was around 55 years for women and 59 years for men. This means that the large inflow of new beneficiaries noted at the beginning of 1990s, was mainly due to introduction of new options for early retirement in 1990. Reduction of average retirement age before 1998 was due to the effect of mass retirement decisions prior to the withdrawal of early retirement possibility in 1998. This is the effect of additional inflow to old-age of those persons, who otherwise would continue work, but were afraid of losing the right to retire after the change in the legislation. The initial decrease was followed by the increase in average retirement age. From 2003 we observe again the reduction of average effective retirement age that could be related to the withdrawal of right to early retirement after 2007, caused by the introduction of pension system reform in 1999. The drop in recent years may be particularly linked to the increased inflow of teachers exercising their right to early retirement.

Figure 3. Average effective retirement age

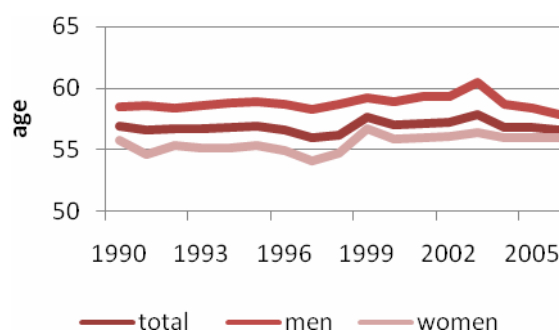
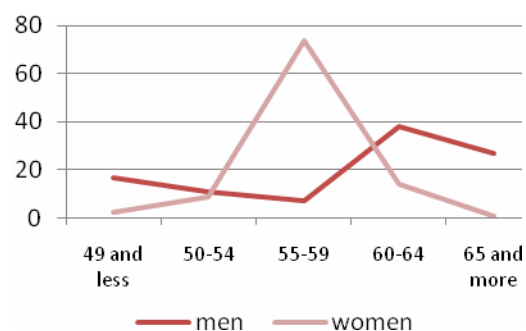


Figure 4. Age structure of new old-age pensions granted in 2006



Source: ZUS

In 2006 the average retirement age of persons who were granted old-age pensions was 56.6 years (of which 57.9 for men and 56.0 for women). Only 26.6 per cent of men and 15.1 per cent of women retire at or above legal retirement age. Majority of both men and women retire earlier. However, the retirement probability by age differs for men and women. In the case of women, there dominant retirement age is 55. More than 70 per cent of women retiring in 2006 did that within the age bracket 55-59. This is related to the existing legal possibility of early retirement at age 55 if the total work experience is more than 30 years (including periods of university education and child care leave). In the case of men, the retirement probability by age is different. Around a fifth of retiring men retire at age 49 or earlier – these are miners, and to a lesser extent teachers, who can retire after required number of years worked in their profession (25 years and 30 years respectively), without the age limit.

Almost half of men retire at age 60-64. It can be assumed that these are men working in special conditions that allow early retirement or those, who are not able to continue working due to their health condition, that also allows to retire at age 60.

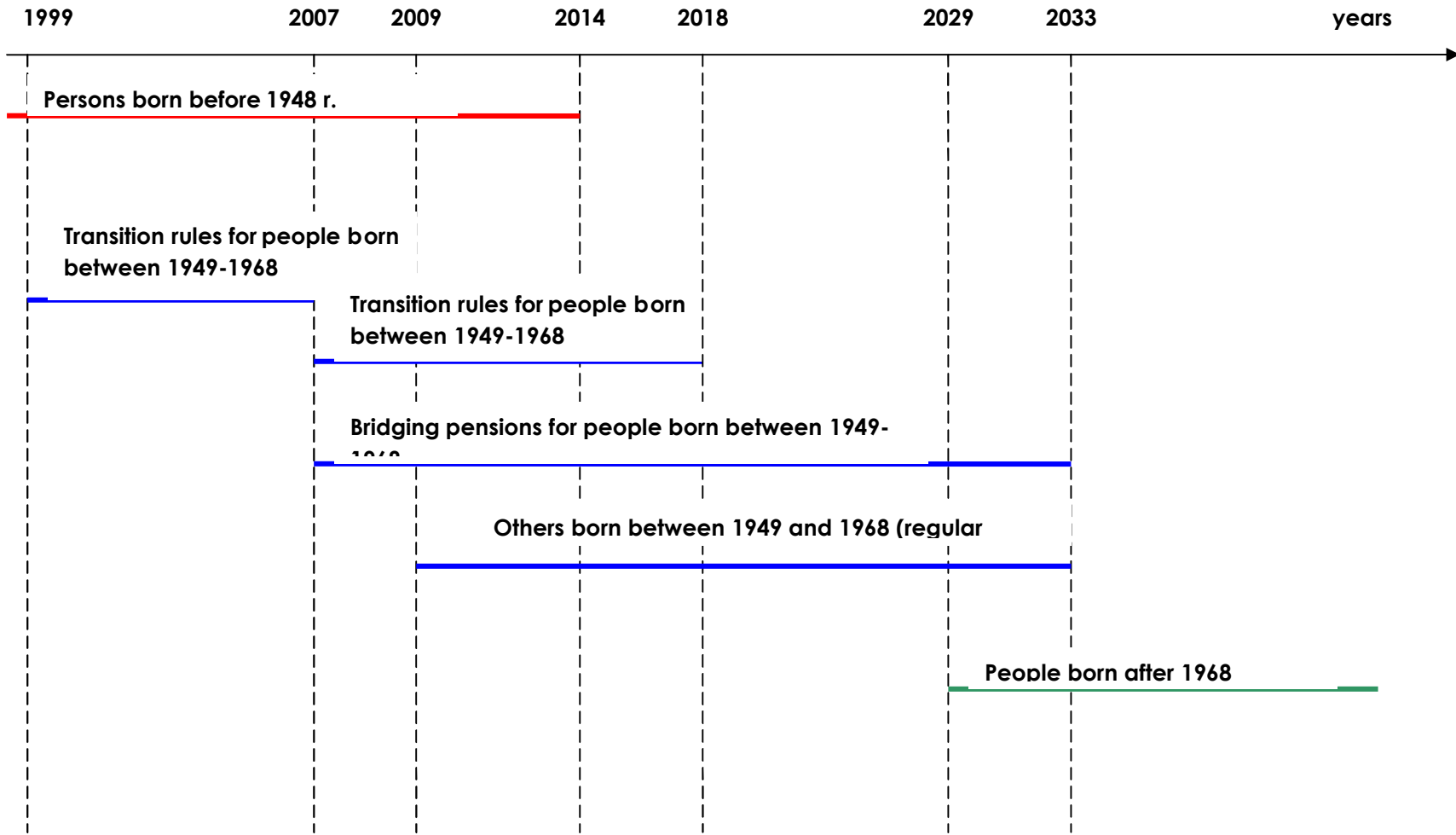
According to the current legislation, from 2008 early retirement options will not be allowed.² This system should be replaced by the so-called bridging pensions that would be granted to people working in special conditions and special character, based on the new list (theoretically medically verified). The government work on those pensions has been continued for the past 8 years, and the system is still not proposed. This shows that early retirement is one of the most sensitive political issues in Poland. The government prepared a new proposal in 2007 that is discussed with social partners. However, the proposal does not include the list of professions that would be covered by the system, which means that it is not possible to assess how many people will be covered by this new scheme.

² However, in September 2007 the Polish government proposed the draft law that extends possibility to retire early according to the old system for 2008.

Figure 5 illustrates existing options to receive either early retirement pension or bridging pension, depending on birth cohort.

To summarize, the evidence from Poland shows a direct link between existing legal options for early retirement and economic activity of older workers. Existence of numerous opportunities to receive a long-term benefit (early retirement pension, disability pension or pre-retirement benefit) has an impact on the reduction of economic activity. As a result, the vicious circle forms: people exercise their opportunity to receive pensions, which leads to the increase of public expenditure and increase of tax wedge that in turn reduces the demand for labour. Reduced demand for labour leads to the reduced employment of older workers, as they are perceived as people that have potentially lower productivity. This in turn increases the pressure to maintain early retirement options in the social system.

Figure 5. Year of reaching the minimum age for the right to (early) old-age pension or bridging pension.



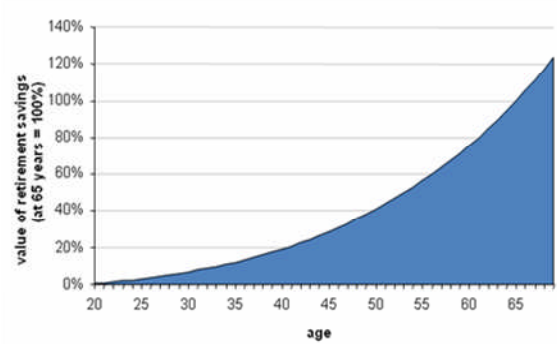
Assumptions: Retirement age: women 60 years, men: 65 years, beginning of work at age 20

The reform of the old-age pension system, introduced in 1999 is design to break the vicious circle described above. This includes first, abolishment of any early retirement within the old-age pension system. All people covered by the new system will not be able to retire prior to the legal retirement age, set at the level of 60 years for women and 65 years for men. This rule, fully implemented will lead to the quick increase of retirement ages that should be observed after 2009, when cohorts covered by the new system retire.³

Additionally, the new system has also mechanisms that encourage extension of working lives. The new pension system is based on the defined contribution principle and financed from two accounts: notional (pay-as-you-go) and funded. In both parts of the mandatory system, the pension level depends on two main factors: value of the individual account and life expectancy on retirement age. As shown in Figure 6, the accumulation of pension savings increase at the end of the working career, when the base for potential returns is highest. Additionally, as the retirement decision is postponed, life expectancy also decreases. Thus, the incentives to prolong working lives are quire strong.

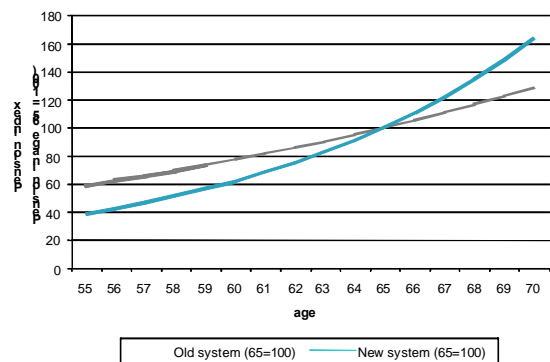
Figure 7 shows the comparison of relative pension level in the old and new pension systems in Poland, assuming that the pension granted to 65-year old is 100%. As one can see, the new systems offers much lower benefits if the retirement decision is taken prior to the age of 65 as well as significant increases of benefits, if the retirement decision is taken later. Hopefully, it will lead to further extension of working lives in Poland.

Figure 6. Accumulation of pension capital



Source: Author's calculations

Figure 7. Changes in pension level depending on retirement age



³ It should be noted that the initial assumptions of the pension reform were watered down by the extension of transition rules for early retirement for an extra year as well as reintroduction of special early retirement pensions for miners. This change happened in 2005, preceding the Parliamentary election as a response to the manifestation of miners in front of the Parliament.