# A brief description of key features of the new Polish pension system

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## I. Basic principles of the new system can be summarised as follows:

- Focusing on the mandatory part of the pension system;
- Separation of the old-age part of social security (OA) from the non-old-age part of social security (NOA);
- Termination of the OA part of the previous system;
- Creation of a new OA pension system, entirely based on individual accounts;
- Splitting each person's OA contributions between two accounts (first account – NDC, second account – FDC, see below);
- Annuitisation of account values (NDC as well as FDC) at the moment of retirement;
- Minimum pension supplement on the top of both annuities if their sum is below certain level (paid out of the state budget).

NDC (non-financial defined contribution) – individual accounts based on quasi-bonds (gov.) not traded in financial markets, bringing rate of return equal wage sum growth (GDP growth in long run).[2]

FDC (financial defined contribution) – individual accounts based on instruments traded in financial markets.[3]

Both accounts are annuitised at the same moment and play exactly the same role within social security.

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[2] There is a tax on yields (25%).

[3] There is no tax on yields at the moment.

Retirement age does not play any active role in balancing the new system. Retirement age is still important from the point of view of social policy and labour supply. For these reasons in the new system minimum retirement age is set at 60 for women and 65for men.[4] The system itself can be run at any retirement age.

## II. Individual accounts (both NDC and FDC)

The new system is based on the same contribution inflow as the previous one. The main change is changing the way in which retirement obligations are defined.

Table 1. Mandatory contributions in Poland before and after implementation of the new pension system

| | Total | NDC individual account | FDC individual account | Other elements of the system |
|---|---|---|---|---|
| before 1-Jan-1999 | | | | |
| Mandatory contribution | 36.59[a] | -- | -- | 36.59 |
| since 1-Jan-1999 | | | | |
| Mandatory old-age contribution | 19.52 | 12.22 | 7.3 | -- |
| Other mandatory contributions | 17.07 | -- | -- | 17.07 |

[a] Equivalent of 45 percent (after grossing-up).

From the individual perspective, the new system is a method of life cycle income allocation.

[4] Initial reform project set retirement age at 62 for both genders. For political reasons this was not accepted. Hopefully this will be possible in the future but up to now no decision has been taken.

- Contributions based on a fixed percent of individual earnings create account values.
- Account balances from the close of the preceding period earn a rate of return based on the growth of the sum of paid contributions.
- Accumulated account values are annuitised at the time of retirement
- Annuities are calculated on the basis of accumulated capital and life expectancy at the age of retirement.
- Technical (demographic) reserves are created.

From macroeconomic perspective the system is a method of sharing GDP between generations. The key feature of this system is stabilisation of the share being transferred to the entire retired generation.

## III. Phasing-in

The entirely new system started on 1 January 1999. There was no switching option. Decisions taken until 31 Dec. 1999 concerned only choosing a version of the new system (see below).

Table 2. Introduction of the new system (age groups)

| **New system** (people born after 31 Dec. 1948) | | **Old system** (people born before 1 Jan. 1949) |
|---|---|---|
| People born after 31 Dec. 1968 | People born before 1 Jan. 1969 | |
| Automatically covered by the new system; OA contribution automatically split between two accounts (NDC+FDC) | Automatically covered by the new system; OA contribution either split between two accounts or paid into one account (NDC+FDC) or NDC | Stay in the old system (no possibility to switch for the new one);<br><br>no accounts |

## IV. Institutions serving the system

| | |
|---|---|
| Registration and other initial procedures | ZUS |
| Collection of contributions | ZUS (can be privatised) |
| Transfer of contributions to OA individual accounts and NOA parts of social security | ZUS (can be privatised) |
| Running NDC accounts | ZUS (can be privatised) |
| Running FDC accounts | PTEs (private) |
| Running NDC annuities | ZUS (can be privatised) |
| Running FDC annuities | to be decided (private!) |

The following criteria should be met by technical and organisational arrangements concerning the way annuities are paid out:

- realisation of the social goal;
- no exposure to discrimination;
- Pareto efficiency;
- implementability.

## References

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