Poland mixes politics with pensions—with mixed results

By Editor Test *Wed, Jan 12, 2011*

Polish workers pay 19.5% of taxable income into the mandatory pensions system, of which 12.2% goes into a plan like our Social Security and 7.3% goes into privately-run DC plans. Starting this year, much of the 7.3% will go to a government-run DC plan instead.

Poland's "second-pillar" pension system, a defined contribution plan, is set for a radical overhaul in 2011 under a compromise that maintains the contribution level, but slashes the amount managed privately.

Under Poland's existing system, workers pay 19.5% of taxable income into the mandatory pensions system. Of this, 12.2% is retained by ZUS, Poland's Social Insurance Institution, which is analogous to the Social Security program in the U.S., and 7.3% goes into pension funds (OFEs) managed by private-sector financial institutions.

In 2010, Poland's 14.9 million second-pillar members transferred the equivalent of €707 million or $915.4 million to the OFEs. The OFEs are major players on the Warsaw Stock Exchange (WSE), with some 36% of €55.4 billion ($71.7 billion) of net assets invested into shares at the end of 2010.

On December 30, Poland prime minister Donald Tusk announced that the government proposed to retain the 7.3% contribution, but direct only 2.3% to an OFE. The remaining 5% would be managed in newly created second-pillar individual sub-accounts by ZUS, with an annual return indexed to GDP growth and inflation.

The changes to Poland's pensions system have been intensely debated for the best part of 2010 against an economic background of a growing government deficit and public debt.

Under EU procedures, contributions to the second pillar counted as budget expenditure. On 10 December, Tusk wrested a significant concession from the European Commission, which will now allow EU member states that instituted second-pillar pensions to offset the cost of these reforms against their budget deficit and debt.

Nevertheless, by the end of 2010, Poland's debt was running close to 55% of GDP, the point past which cuts in pensions and other government programs will be triggered. The changed system will, the government claims, reduce state subsidies for pension payouts.

Share prices on the WSE fell sharply in response to the government's news. The government says it will extend the OFEs' equity investments by replacing the existing one-size-fits-all portfolios with lifecycle funds, including an aggressive, equity-weighted portfolio for younger members, although it hasn't offered details.

The government also proposes that, as of 2012, individuals can make a voluntary, tax-deductible top-up starting at 2% of wages and rising to 4% by 2017. Meanwhile, the 5% share to be managed by ZUS will also start falling after some two years from the revised system's start, to 3.8% by 2017.