Pension systems – a challenge for the future

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This year's "silver jubilee" i.e., the 25th anniversary of the transformation of the Polish economy from a centrally-planned towards a free-market one provides an opportunity to take stock of unquestionable successes it gave rise to. Progress that has been made in Poland is visible to the naked eye. This is also confirmed by statistics. Poland is ranked increasingly high the Human Development Report, a compilation based on the Human Development Index (HDI) and published by the United Nations Development Programme. In the latest ranking, it is 39th among highly developed countries. Moreover, Poland occupies the 13th place in the world and 5th in Europe in terms of investment attractiveness, and is the only country of Central and Eastern Europe with such a high position.

Despite these successes, there are still serious problems to be solved in many areas of economic and social life. One of such critical issues is pension schemes. Many other countries, even more developed, are facing the very same challenge. While these difficulties are primarily due to demography (aging population), they are also largely systemic in nature. The reason behind them is irregularities in the pension policy that manifest themselves in inadequacy of pension systems vis-à-vis new civilisational challenges i.e., rapid changes in the demographic and economic situation in the world. The civilisational progress, especially in medicine and health care, results in one of the most important social achievements i.e., human life extension. This, in turn, points to a fundamental importance of the pension policy and pension systems optimisation.

These issues are the subject of "Pension Reform. A Short Guide", a book by Nicholas Barr and Peter Diamond, published in Polish by the Polish Economic Society. Its authors are world-class economists. Peter Diamond was awarded the Alfred Nobel Prize in economic sciences by the Bank of Sweden in 2010. The book examines mistakes made by some countries in the selection of a pension system, including mistakes in privatisation concepts recommended by the World Bank.

The importance of the issue can hardly be overestimated. It has a special meaning also (and perhaps even mostly) in Poland, especially that pension regulations have constitutional grounding. According to Art. 67 of the Polish Constitution, "A citizen has the right to social security in the event of inability to work due to illness or disability, and after reaching the retirement age." The Polish pension system (characterized in the book along with the systems existing in other countries) is a mixed, public-private or solidarity-capital, and it replaced the previous redistribution-based state scheme. It comprises two mandatory pillars: the first pillar (redistribution) - based on the Social Security Fund that is managed by the state-owned Social Insurance Institution (ZUS), and the second pillar (capital) - based on private open pension funds (OFE). The system also provides for the third pillar, which is voluntary and based on the individual additional insurance and allows for tax credits. This system was implemented in Poland in 1999 in the framework of the pension privatisation process recommended by the World Bank.

Over more than 14 years of the mixed scheme being in force in Poland, its various weaknesses have come to light. Some major changes have been introduced earlier in 2014 in order to eliminate them. One of them is voluntary participation in the capital-based pillar – OFE – it is no longer mandatory. Since April 2014, future pensioners are able to independently decide whether to transfer part of their contributions to OFE and to rely solely on ZUS. These changes continue to arouse much controversy and doubts. Analyses by Baar and Diamond can help unravel them.

The authors came to the conclusion that a mandatory, capital-based pillar does not solve demographic problems or problems related to public debt. They argue that "by choosing the pension system, individual countries should not introduce a system that exceeds their administrative and financial capacities". Neither should they open individual pension accounts (mandatory or considered as an acceptable option in the compulsory insurance system) until they reach the ability to settle investments made by pension funds, to control assets and ensure problem-free pension payments.

Interestingly, referring to the third pillar, the authors of the book claim that voluntary individual retirement savings' plans in poor countries should not benefit from tax brakes, since state budget revenues are already very limited. What is important is to suggest a simple and reliable form of making voluntary savings.

The book's content is fully supported by Oxford's Nicholas Stern who finds that "it is the most important piece of literature on pensions policy." Stern's statement that "we are very fortunate to have this book in our hands in these times" fully applies to its Polish edition.

Analyses formulated by Diamond and Baar correspond closely with those made by Michel Orenstein in his book "Privatizing Pensions: The Transnational Campaign for Social Security Reform", whose Polish version was also published by the Polish Economic Society. ::