

How to Mobilize Additional Pension Savings?

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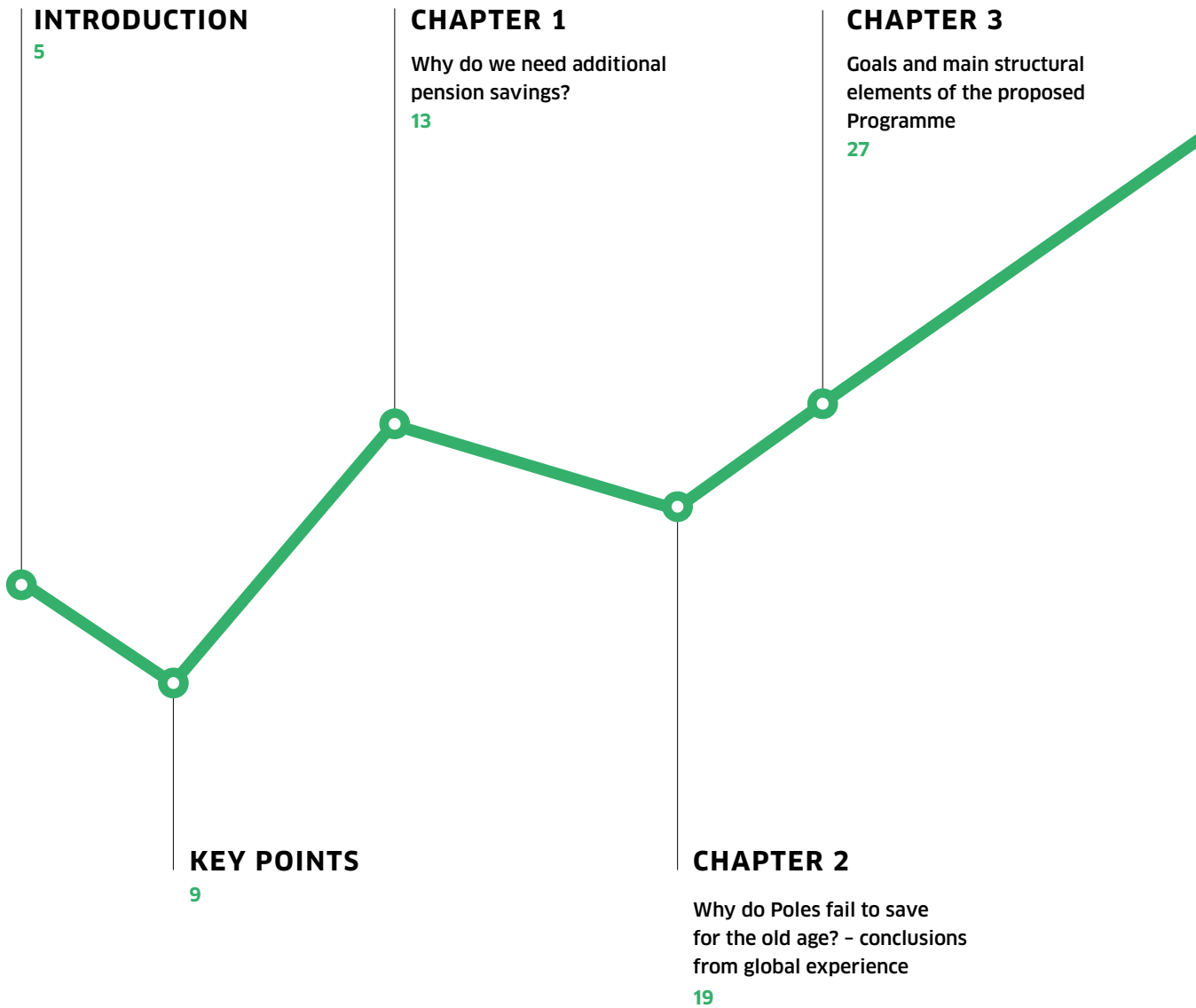
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Introduction

Polish economy suffers a deficiency of long-term domestic savings. At the same time future pensioners need additional capital for their old age in order to cushion the expected sharp decrease in the amount of pensions granted in the compulsory pension system compared with salary level. Poles, in their own best interest, should save for their pensions, which would simultaneously bring benefits for the country's economy. However the programmes of additional savings supported by the state enjoy little interest.

Why do the Polish people not save for their pensions and act against both their own interest and public interest?

An analysis of global experience indicates that contrary to frequently held popular opinion, the Polish people in their individual decisions concerning pension do not behave differently from citizens of other countries. In other countries, like in Poland, mainly well-off persons save actively for their pensions and encouraging people who earn little to save for their old age by offering them tax breaks is in general ineffective. Universal membership is guaranteed by mandatory or quasi-mandatory savings programmes. In the case of voluntary systems a high percentage of participation is successfully achieved in some schemes to which employees are enrolled automatically and where a withdrawal requires an active decisions with simultaneous clear financial incentives to remain in the system.

This Report in **CHAPTER 1** answers the question why both as the country and as individual citizens we need additional pension savings.

CHAPTER 2 presents conclusions from an analysis of experience from other countries and from Poland with respect to mobilization of pension savings.

In **CHAPTER 3** we formulate goals which the national programme for mobilization of additional pension savings should pursue, and then we present a proposal of new solutions for the 3rd pillar in Poland (hereinafter referred to as the “Programme”), drawing on foreign solutions which seem most appropriate. The primary goal of the Programme should be, in our opinion, to ensure a high level of employee participation and create effective incentives to convert the accumulated capital into an annuity. At the same time, costs of the Programme must be at an acceptable level from the perspective of employers and the state budget.

The main instruments proposed to achieve these goals include:

- 1.** Automatic enrolment with the possibility to opt out individually.
- 2.** Three sources of financing: employee’s contribution, employer’s contribution, budget subsidy.
- 3.** Use of the Social Insurance Institution (ZUS) to transfer the contributions to pension funds.
- 4.** Limits on the cost for the Programme members.
- 5.** New structure of a “flexible annuity” allowing creation of more attractive conditions of converting the accumulated capital into a lifelong annuity.

CHAPTER 4 presents estimated effects and costs of the Programme from the point of view of employees, employers and public finance. With the proposed parameters the Program seems to be attractive for employees, in particular those with low salaries, but it also means a determined cost for the employers and the state budget. From the perspective of public finance it is important that additional pension savings generated annually will be a few times higher than the costs incurred by the budget and moreover the future budget spending on subsidies to the minimum pension threshold will decrease.

CHAPTER 5 presents proposals concerning further use of IKE and IKZE programmes. The proposals are to a large extent independent from the ones regarding the Programme, discussed in chapters 3 and 4.

The Report uses the recommendations of the European Financial Congress (2014), in the development of which we were involved. In many respects our approach is concurrent with the one presented in the proposal of the Ministry of Treasury (2014). Our assessments and conclusions to a great extent coincide with those presented in the reports of the World Bank (2014) and Polish Association of Economists (2014), although specific proposals sometimes differ.

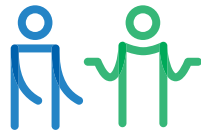
We believe that a launch of an effective national programme for mobilization of additional pension savings should be preceded with a public dialogue between three parties: trade unions, employer organizations and the government. The effect of the dialogue should be a consensus as to the Programme goals as well as a possible modification of specific solutions so as to take into account sensitivity of individual parties.

To verify whether the proposed solutions will prove effective in ensuring appropriate participation of employees it will be advisable to use focus group research and questionnaire-based surveys.

The Report has been prepared on commission of the Polish Chamber of Pension Funds (Izba Gospodarcza Towarzystw Emerytalnych, IGTE). It presents Capital Strategy expert opinions and does not have to coincide with the position of IGTE.

The first version of the Report was publicly released on 4 December 2014. The estimates concerning possible impact of the proposed solutions on the level of future pensions were appended to the present version.

Key points



Why do we need additional pension savings?

1. Scarcity of long-term national savings poses a threat to macroeconomic stability and constrains Poland's development possibilities

Macroeconomic risk

Poland's International Net Investment Position (INIP) is deeply negative. A very high share of foreign investors among holders of Polish treasury papers is also worrying. Poland is classified among the countries which are most sensitive to the outflow of foreign capital among the emerging economies.

Constraint on availability of long-term credit

Given the international and European regulatory changes in the banking sector, the deficiency of long-term national savings will limit the availability of bank financing for long-term infrastructure and energy projects as well as for housing.

Constraint on development of capital market and on growth of locally controlled companies

Long-term national savings:

- Increase the availability of capital which may finance the economy through the stock exchange.
- Reduce stock exchange dependence on foreign capital.
- Enable development of long-term institutional investors such as pension funds and investment funds whose presence may to a certain extent be an alternative to foreign control over Polish companies.

Therefore, a deficiency of long-term national savings will hinder the development of Polish capital market and of companies with decision-making centres in Poland.

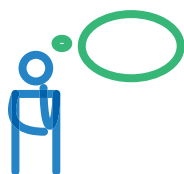
The problem will not disappear by itself should Poland enter the euro zone

The risk related to the deficiency of national savings will not disappear by itself also if Poland joined the euro zone. On the contrary, the effects of the current account deficits linked to the loss of competitiveness may turn out more painful in conditions of functioning in a single currency area than in the case of a country having its own currency.

2.Reduction of the level of pensions granted in the mandatory pension system as compared with salaries will generate serious social and economic problems

In the next decades, there will be a deep reduction in the level of pensions granted under the mandatory pension system as compared with the salaries, which will constitute a serious social problem. An increase in the number of persons entitled to subsidies from the state budget to reach the minimum pension level will create a major economic burden for the public finance.

3. Additional pension schemes (3rd pillar) could contribute to mitigate the decline in the replacement rate, facilitate financing of the development and increase macroeconomic stability of the country



Why do Poles fail to save for the old age? – conclusions from global experience

1. Universal membership is guaranteed by mandatory or quasi-mandatory systems

In the leading countries in terms of the ratio of pension fund assets to GDP (incl. the Netherlands, Iceland, Switzerland, Denmark) additional pension insurance is mandatory or quasi-mandatory for employees. That ensures a high level of participation.

2. Encouraging people with low earnings to save for the old age by offering them tax breaks is ineffective

In general, tax breaks neither increase the number of people saving nor bring a significant growth of savings in the economy. They only cause a shift of savings to the products supported with subsidies, and in the case of EET they mean fiscal transfer from the total of taxpayers to the population with higher income.

3. In the case of voluntary systems an effective method of stimulating a high level of participation is a combination of automatic enrolment with strong incentives to remain in the system in the form of employer's contribution and budget subsidy

4. To-date attempts to promote voluntary pension savings in Poland have failed

5. With regard to pensions, Poles do not behave differently from citizens of other countries

Contrary to popular opinions, Poles in their individual decisions on pensions do not behave differently from citizens of other countries. The low level of additional pension savings in Poland is above all the effect of a lack of appropriate institutional solutions. An attempt should be made to create such solutions.



New solutions for the 3rd pillar in Poland – proposal for discussion

1. Proposed goals and limitations of the Programme

1.1. Participation level over 80% among the total number of employees and no less than 70% among employees with salaries below the average salary in the economy.

1.2. Annuity as the basic form of using the accumulated savings.

1.3. Acceptable costs for employers.

1.4. Limited costs for the state budget.

1.5. Conditions for the already existing Employee Pension Schemes (Pracownicze Programy Emerytalne, PPE) should not deteriorate, and participants of those schemes should not find themselves in a worse situation than employers or employees of the companies which will only start additional pension schemes based on new regulations.

2. Main structural elements and effects of the Programme

2.1. Automatic enrolment, with the possibility to opt out from the Programme individually in the period between the 2nd and the 8th week from the moment of the automatic enrolment as well as in subsequent decision-making slots every four years.

2.2. Three sources of financing:

- Employee's contribution: 1% of gross salary in the first year of the Programme functioning and 2% starting from the second year.
- Employer's contribution – obligatory supplement to the employee's contribution in the same amount.
- Budget subsidy in the amount of PLN 40 monthly, however no more than the employee's contribution.

2.3. Pension fund is selected by the employer as a default option, unless the employee decides to select another fund.

2.4. The contributions and the budget subsidies are transferred to the funds through ZUS.

2.5. Pension funds operate under the supervision of the Polish Financial Supervision Authority (KNF) and offer standardized products with limited costs.

2.6. Withdrawal of the accumulated assets from the Programme before reaching the retirement age may only concern the assets from the employee's contributions (in total or in part). The withdrawn amount is reduced by capital gains tax. The proportionate part of the assets from the budget subsidies is cancelled and the proportionate part of the assets from the employer's contributions is transferred to the employee's pension account at ZUS.

2.7. Annuity is the basic form of payment of benefits. Exceptions include:

- Possibility of a one-off withdrawal (or another free disposal) of up to 25% of the accumulated savings after retirement.
- Possibility to freely dispose, after reaching the retirement age, of the remaining assets from the Programme by persons who have already secured for themselves lifelong benefits from all sources in the total amount of at least 250% of the average pension.

2.8. Disposal of the assets after reaching the retirement age in any form other than the above described results in the loss of the assets from the budget subsidies.

2.9. The annuity in its part deriving from the budget subsidies will be included in the minimum pension.

2.10. In order to create more attractive conditions of converting pension savings into an annuity, the institution of "flexible annuity", administered by a public institution will be created. The institution paying out such annuity will not incur the risk of longevity or the risk of return rate on investment because their effects will be amortized by annual adjustment of the amount of benefits for the whole cohort.

2.11. Parameters of the Programme are most beneficial for employees with low salaries: an amount constituting almost 2.5 times of the lost current income will be transferred to the pension account of a person earning PLN 2 000 gross. As the salary increases, the multiplier gradually decreases, **but the Programme is attractive also for people with very high salaries.**

2.12. In the case of the employee who earns national average salary and participates in the Programme throughout the entire period of employment, an **increase of the total net pension (from both mandatory and additional system) may be between 22% and 29%**, depending on what portion of the capital accumulated in the additional system will be dedicated by the employee to the annuity.

2.13. Costs of the Programme for employers are estimated at 0.56% of the total cost of salaries and employee benefits in the first year of the Programme and 1.12% in the following years.

2.14. Direct negative effect of the Programme for the state budget may be estimated at net 0.24-0.28% GDP annually.

2.15. The Programme will have a positive impact both on the total amount of savings in the economy and on their structure:

- Net increase of savings in the economy will be ceteris paribus approximately 0.22% GDP annually, which will contribute to improvement of Poland's INIP.
- Increase of long-term pension savings will be more than four times higher than the net budget cost of the Programme and (starting from the second year) will amount to 1.15% GDP annually, which in 2013 would have corresponded to PLN 18.7bn.

2.16. Future spending of the state budget on subsidies to minimum pensions will decrease.

CHAPTER 1

Why do we need additional pension savings?



Why do we need additional pension savings?

1. The scarcity of long-term national savings poses a threat for macroeconomic stability and constrains Poland's development possibilities

1.1. Risk for macroeconomic stability

One of the key indications for assessment of the risk related to country's external equilibrium is its International Net Investment Position (INIP)¹. The indicator informs whether a given country is a net creditor or debtor to foreign countries. Poland's INIP has been deteriorating for a number of years, as is illustrated in **GRAPH 1**. In 2013 the INIP to GDP ratio deteriorated by 2.2 percentage points and reached a negative value of 69.9% GDP. Such level of INIP positions Poland in the group of countries with the greatest risk among the world's emerging economies.

An important risk factor related to the scarcity of national savings is also a significant share of foreign investors among holders of Polish treasury papers. Since 2007 the share has increased by more than 20 percentage points and currently (according to the data at the end of August 2014) stands at 58.8%, as illustrated in **GRAPH 2**.

The Economist weekly (2013) announced the capital-freeze index, which measures country's sensitivity to a sudden outflow (or ceasing of inflow) of foreign capital. In this index Poland was classified as the third (after Turkey and Romania) most sensitive to an outflow of foreign capital among the emerging economies².

1.2. Constraint on availability of long-term credit

Regulatory changes in the banking sector under the Basel III Accord considerably reduce the possibilities of granting long-term loans by banks based on short-term deposits. Hence in order to enable financing of long-term infrastructure and energy projects, as well as housing, it is necessary to stimulate the development of long-term national savings.

1.3. Constraint on development of the capital market and on growth of locally controlled companies

Mobilization of long-term national savings is essential for the development of the Polish capital market. Long-term national savings:

- Increase availability of capital which may finance the economy through stock exchange.
- Reduce stock exchange dependence on foreign capital.
- Enable development of long-term institutional investors such as pension funds and investment funds whose presence may to a certain extent be an alternative to foreign control over Polish companies.

1.4. The problem of the lack of savings will not disappear by itself should Poland join the euro zone

The risk generated by the insufficient level of national savings will not disappear by itself also if Poland joined the euro zone. The experience of the euro zone crisis shows that within the single currency area the risk for the economy may come not only from budget deficits but also from current trade deficits generated by private capital flows. Current trade deficits related to decreasing competitiveness of the economy are dangerous within the euro zone because if a country does not have its own currency, eliminating a serious gap in its international competitiveness is extremely difficult, long-lasting and expensive both economically and socially. Experience of the global financial crisis and of the euro zone crisis confirms that the ability to generate national savings and to use them effectively for investments which increase productivity of the economy is of key importance for long-term economic growth.

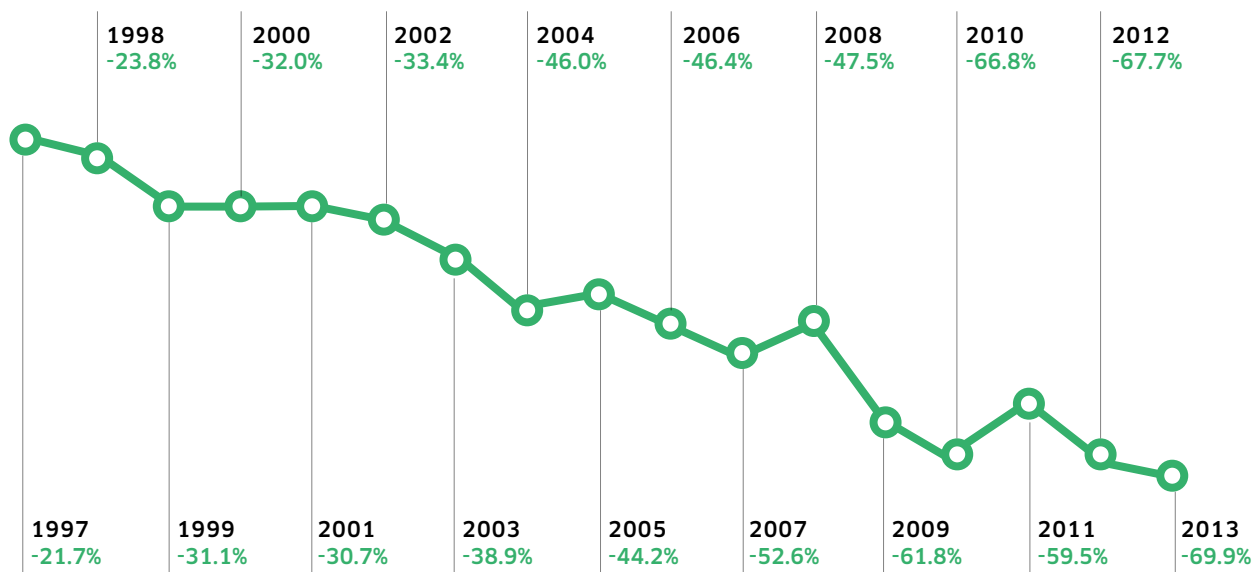
2. Decrease of the level of pensions granted in the mandatory pension system as compared with salaries will generate serious social and economic problems

In the next decades, in the mandatory pension system there will be a significant reduction of the level of pen-

GRAPH 1

The ratio of Poland's International Net Investment Position to GDP in 1997-2013

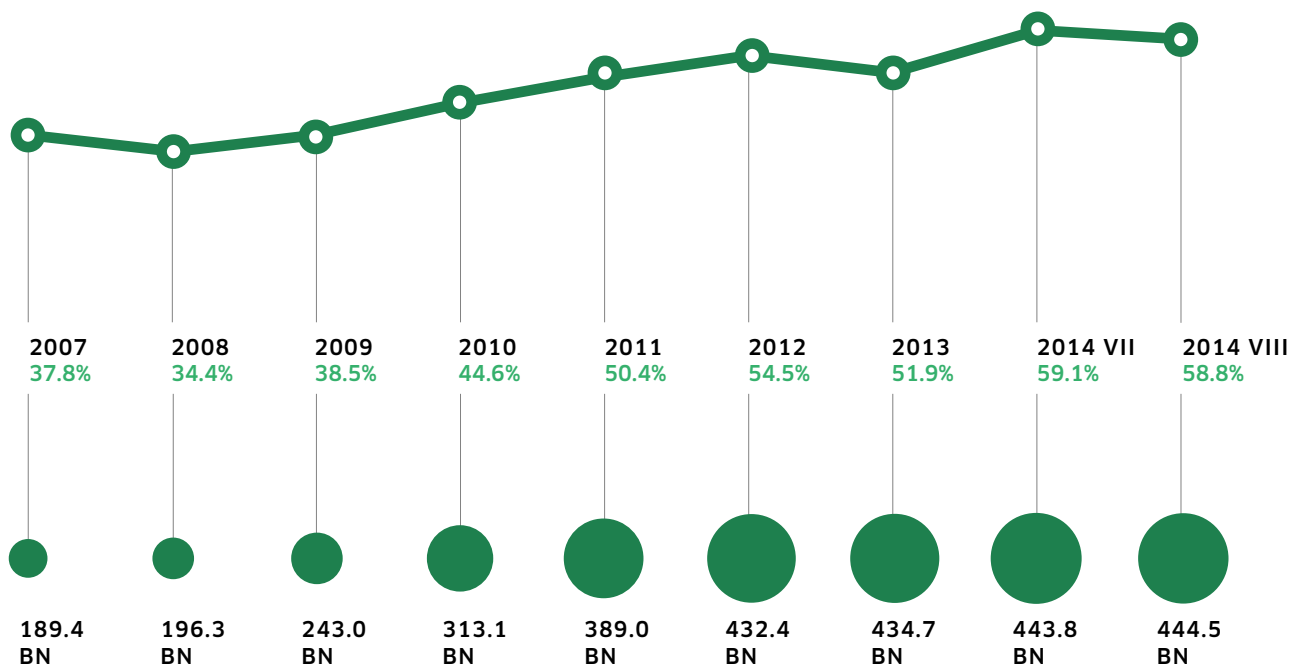
Source: Data for 2008-2013 on the basis of: the National Bank of Poland (2014); data for previous years - from the NBP reports "International Investment Position of Poland in..." from previous years.



GRAPH 2

Share of foreign investors in State Treasury debt (in billion PLN and in %)

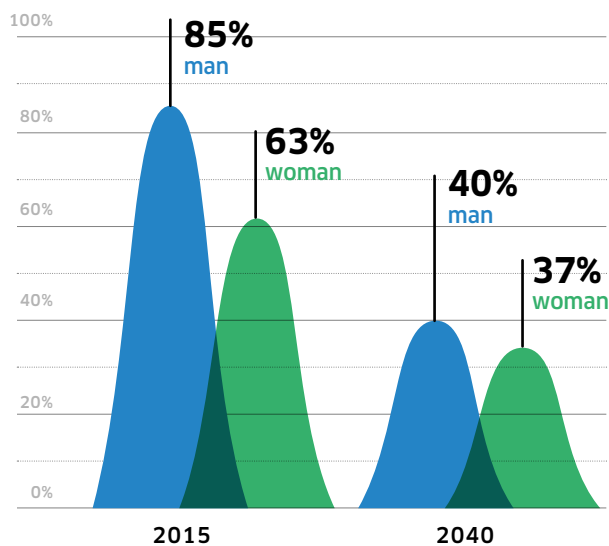
Source: Own analysis based on data of the Ministry of Finance (2014)



GRAPH 3

Forecasted change of adequacy of pensions in Poland in 2015-2040

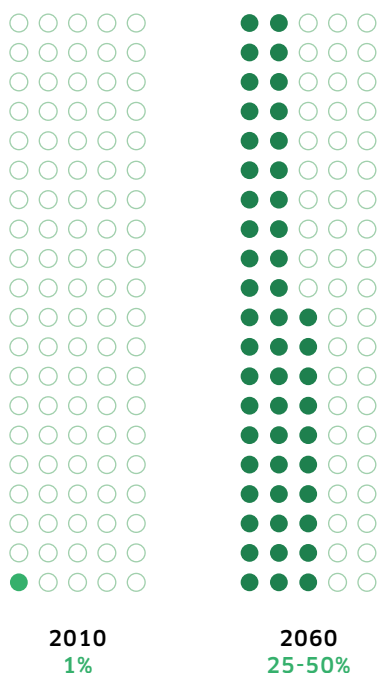
Source: Own analysis based on: Jablonowski, Müller (2013, p. 95-96)



GRAPH 4

Growth of the group of pensions requiring subsidies to the minimum pension in 2010-2060

Source: Own analysis based on: Jablonowski, Müller (2013, p. 95-96)



sions as compared with salaries³. The scale of the phenomenon is illustrated by the data in **GRAPH 3**.

Low level of pensions will be felt as a serious social problem. At the same time there will be a growing number of persons entitled to subsidies from the state budget to achieve the minimum pension level, which will generate a major economic burden. The share of pensions which do not exceed the minimum pension threshold in the total number of pensions granted in a given year may increase from 1% in 2010 to 25-50% in 2060, as is illustrated in **GRAPH 4**.

3. Additional pension programmes (3rd pillar) may contribute to mitigate the decline of the replacement rate, facilitate financing of the development and increase macroeconomic stability of the country

Development of voluntary pension savings may mitigate the effects of the declining replacement rate in the mandatory pension system as well as reduce the need for subsidies to minimum pensions. By generating long-term savings, voluntary pension insurance may facilitate financing long-term development projects, simultaneously increasing the country's macroeconomic stability.

1 International Net Investment Position is the difference between all foreign assets and foreign liabilities of a country.

2 Compare Antczak (2014).

3 The European Commission (European Commission 2012, p. 127-130) uses above all two indicators to assess the adequacy of pensions: the first is the ratio of the average pension to the average salary (benefit ratio); the second is the replacement rate, that is the average ratio of the pension to the salary received just before retirement. Both ratios will decrease considerably in most EU countries in the coming decades. Jablonowski and Müller (2013) use for adequacy assessment the adequacy ratio that is the ratio of newly granted pensions to the average salary in the economy. Since the European Commission's forecasts (2012) do not yet include the effects of extending the retirement age in Poland to 67 years, we quote here the forecasts of Jablonowski and Müller (2013) which take into account those effects.

CHAPTER 2

Why do Poles fail to save for the old age? - conclusions from global experience



Why do Poles fail to save for the old age? – conclusions from global experience

1. The importance of additional capital pension insurance varies greatly across OECD countries

Pension systems in individual OECD countries vary. Most experience comes as a rule from universal state systems based on the pay-as-you-go principle. The importance of additional capital pension insurance differs very much, as is illustrated in **GRAPH 5**.

2. Universal membership is guaranteed by mandatory or quasi-mandatory systems

In the countries, in which the ratio of pension fund assets to GDP is the highest, capital pension schemes are usually de facto mandatory or quasi-mandatory for employees.

This applies in particular to the Netherlands, Iceland and Switzerland, that is the first three countries in the ranking presented in Graph 3 of the ratio of pension fund assets to GDP.

In the Netherlands, if an agreement is concluded between representatives of employers and employees in a given industry, the national law imposes the obligation for employees of companies in a given sector to participate in the pension scheme covering the entire industry. Hence the system of additional pension insurance is defined as quasi-mandatory. The share of employees covered with additional pension insurance reaches there the level of 90%.

In Iceland and Switzerland (respectively number two and three in the ranking) participation in the system is mandatory.

Denmark is the country which leads the OECD ranking of the ratio of total pension assets of all types (that is not only those accumulated in pensions funds) to GDP. In 2012, the ratio in Denmark was 197%, including 123% in insurance contracts and 50% in pensions funds. In Denmark the universal membership in pension insurance schemes is supervised by trade unions and employer organizations, that is why the system is defined as “voluntary” (voluntary in inverted commas) or as quasi-

mandatory. Pension insurance covers there 84% employees and 62 % participate in typical capital insurance.

3. Systems based on tax breaks do not ensure a significant level of participation among people with low and medium income, and in the case of the EET system tax breaks result in a fiscal transfer from the total of taxpayers to people with higher income. They do not bring a significant increase in savings but a shift of savings to the products supported with tax breaks

In voluntary systems, in which tax breaks are the incentive to invest, there is a major share of participants with income higher than average, who would save anyway even without the tax breaks. In the case of the USA, the UK, Germany and Italy an almost ideally growing dependence of participation on income decile was observed⁴.

In consequence, in the case of EET tax incentives cause the fiscal transfer from the total of taxpayers to people with income higher than average who participate in the schemes and the shift of savings to the products supported with tax breaks⁵. That is why the countries using EET taxation system most frequently apply annual allowance limits of contributions or annual limits of income, whereas in the UK there is both annual limit and life-long limit.

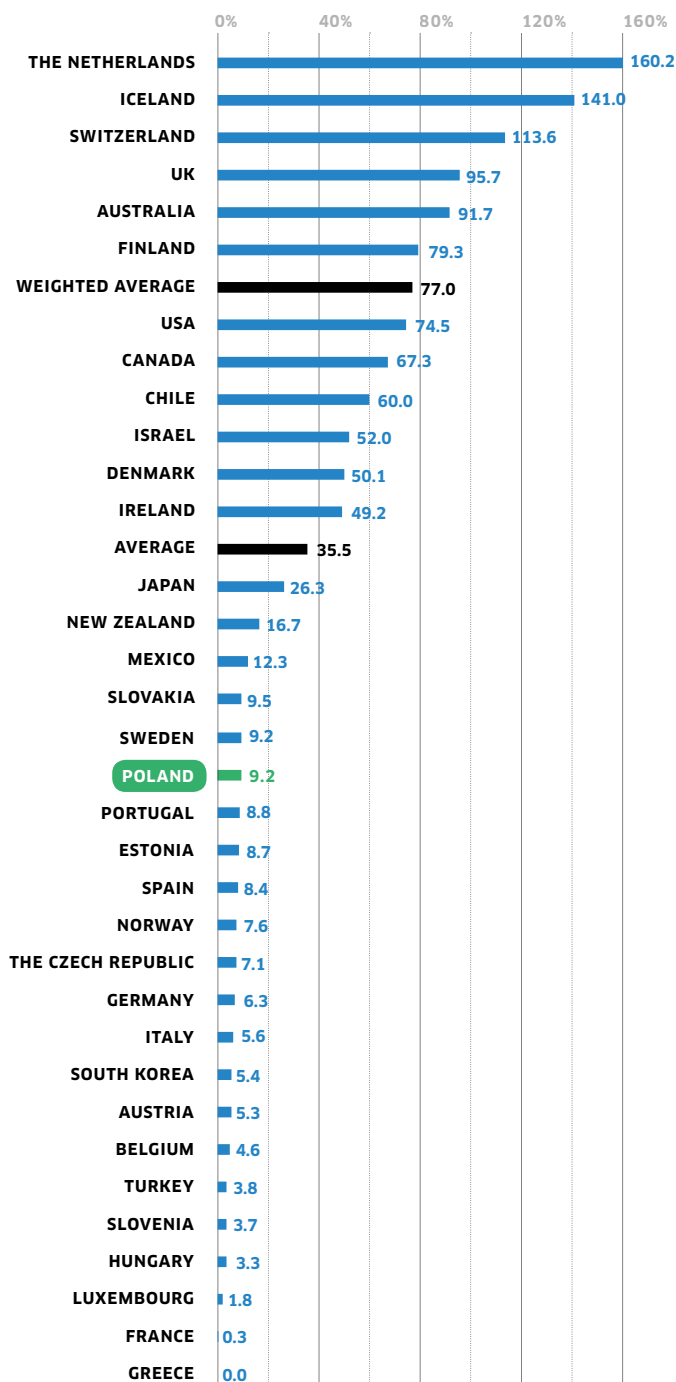
4. A combination of automatic enrolment with strong incentives to stay in the system (in the form of employer's contribution and budget subsidy) might be an effective method of stimulating a high level of participation in the case of voluntary systems

The automatic enrolment is a relatively new solution. It was introduced to a varying extent among others in New Zealand, the UK, the USA and Italy. The solutions introduced in New Zealand and the UK are the most comprehensive. The British universal programme of automatic enrolment was spread over the years 2012 - 2018, that is why it is yet impossible to fully assess the

GRAPH 5

Assets of pension funds as a percentage of GDP in 2012.*

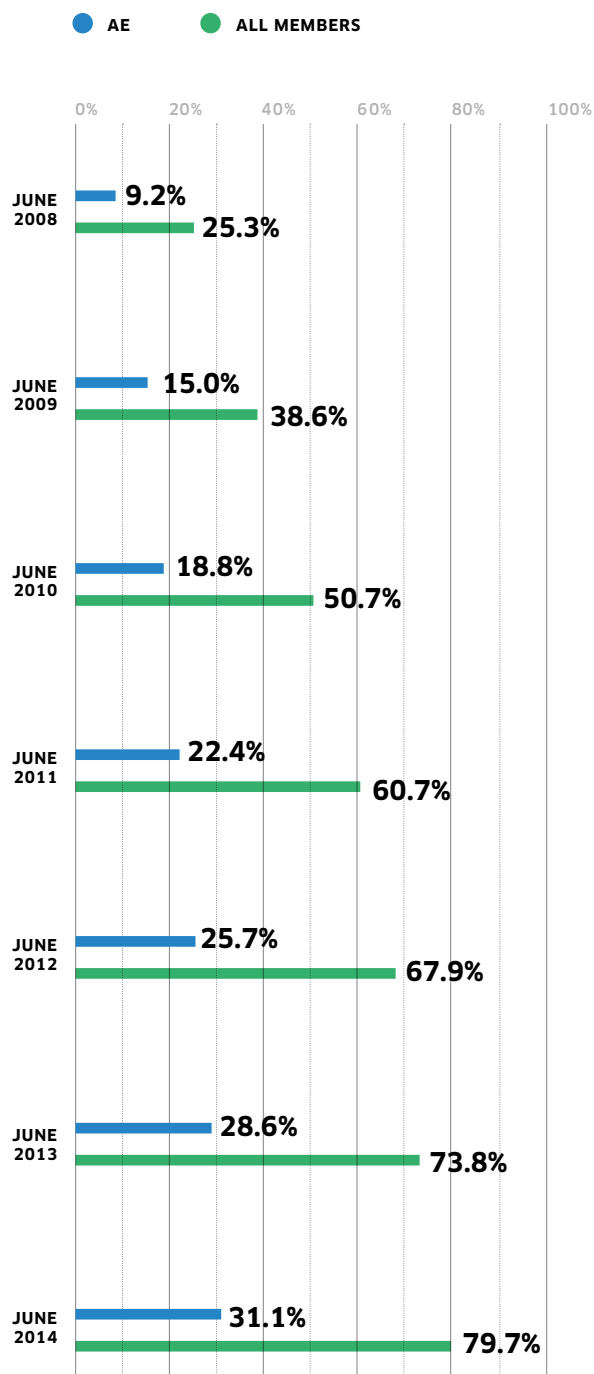
Source: OECD (2013)



GRAPH 6

Share of KiwiSaver members among people in the productive age, including persons enrolled automatically (AE)

Source: Own calculations based on www.kiwisaver.govt.nz and www.stats.govt.nz



* For Poland, authors' own calculations based on the data of the Central Statistical Office (GUS) and of the Polish Financial Supervision Authority (KNF): total net assets of OFE and PFE at the end of the 2nd quarter 2014 (after the National Insurance Institution (ZUS) took over the the OFEs' portfolio of treasury bonds).

effectiveness of the scheme. It is worthwhile paying attention to the to-date experience from the programme launched in New Zealand 2007.

In the New Zealand's system, known as KiwiSaver:

- Each new employee is automatically enrolled to the system with the possibility of opting out from the programme strictly limited in time (between the 2nd and the 8th week of membership in the system). Later the employee has no possibility of opting out of the system and may only change the service provider. In the first months of functioning of the programme over 50% of those enrolled opted out. In 2010 the percentage of people opting out dropped to a dozen or so percent.
- In 2012 participants of the system were able to choose among over 180 pension schemes with varying risk levels, offered by 32 entities, that is banks, pension funds, financial institutions and the government. People who were automatically enrolled in the system but who did not choose a pension scheme are assigned to the scheme selected by the employer or to one of six governmental pension schemes (with a conservative investment strategy).
- If the employee remains in the system, his or her contribution is supplemented with a mandatory contribution of the employer and a government subsidy.
- In 2013 the minimum (by default) employee's contribution was 3% of the remuneration and the additional obligatory contribution of the employer was also 3% of the employee's remuneration.
- The government subsidy consisted of two elements:
 - a) One-off kick-start payment at the moment of joining the system in the amount of NZD 1000 (New Zealand dollars), which was approx. 2% of the average salary in 2012.⁶
 - b) Regular subsidy whose maximum annual limit was initially NZD 1040 (approx. 2% of the average salary), and in 2011, that is four years after the launch of the system, it was reduced to NZD 520 (approx. 1% of the average salary).

Until now New Zealand has not introduced a universal mandatory enrolment. From the beginning of the system functioning only newly employed and those changing work, with few exceptions, are subject to obligatory enrolment. In April 2008 all employees of the public sector were enrolled automatically and in October 2008, that is in the second year of the programme functioning, employees of the education sector were enrolled automatically. In 2011 the Minister of Finance stated that the universal automatic enrolment would be introduced in the budget year 2014/2015 if the budget

were balanced by then⁷. In 2013, however, he said that the regulation would be introduced after balancing of the budget but did not specify any date⁸.

Almost 80% population in the productive age participate in the KiwiSaver system, out of which 31% people in the productive age joined the scheme as a result of obligatory automatic enrolment. Most participants and employers pay the minimum contribution, 3% of the gross remuneration.

As a result of a combination of budget subsidies, employer's contributions, a tax break (until March 2011) and automatic enrolment an impressive rate of participation in the programme was achieved

- 90% of surveyed participants of the system said that the kick-start payment was an important factor making them to remain in the system⁹.
- Among the respondents who joined the programme as a result of automatic enrolment, 45% said they would not participate if they had not been automatically enrolled, and 15% admitted that if it had not been for the limited period when opting out of the system was possible, they would have abandoned the system¹⁰.

The fiscal costs of KiwiSaver functioning, resulting from governmental subsidies to employee contributions and tax breaks for employers, in 2008-2012 are estimated at the total of NZD 4.7bn, which on average accounted for approx. 0.47% GDP.

The automatic enrolment, unless combined with sufficiently strong incentives to remain in the system, does not guarantee by itself a high level of participation. The case of Italy confirms that. In spite of the introduction of automatic enrolment in 2007, only 27% of private sector employees remained members of additional capital pension schemes, the others abandoned the system¹¹.

5. To-date attempts to promote additional pension savings in Poland brought little result, while successive schemes supported by the state (PPE, IKE, IKZE) have decreasing effects

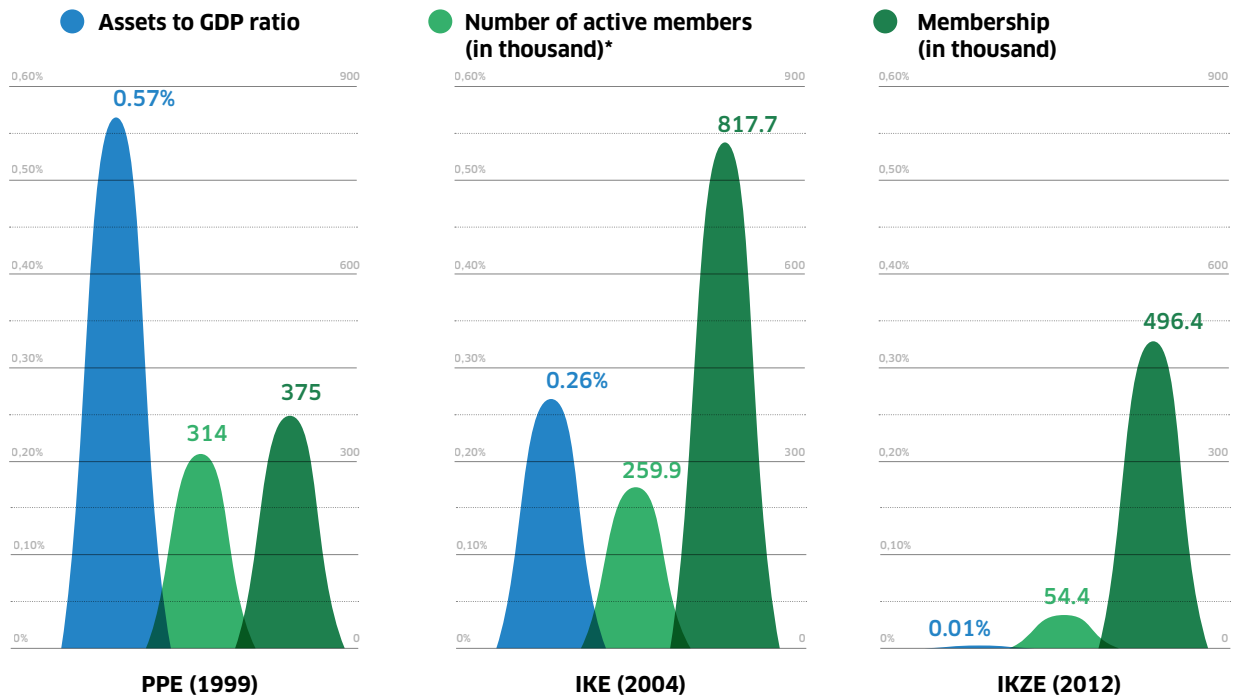
The to-date attempts to promote additional voluntary pension saving with successive schemes supported by the state have brought little result in Poland.

According to the data at the end of 2013, the total assets accumulated in Employee Pension Schemes (Pracownicze Programy Emerytalne, PPE), Individual Pension Accounts (Indywidualne Konta Emerytalne, IKE) and Individual Pension Security Accounts (Indywidualne Konta Zabezpieczenia Emerytalnego, IKZE) were equal to 0.84% GDP, out of which PPE assets were equal to 0.57% GDP, IKE – 0.26% GDP, and IKZE – less than 0.01% GDP. The total number of active members of all

GRAPH 7

3rd pillar in Poland - accumulated assets and membership as at 31 December 2013

Source: Own calculations based on data of the Ministry of Labour and Social Policy, KNF and GUS

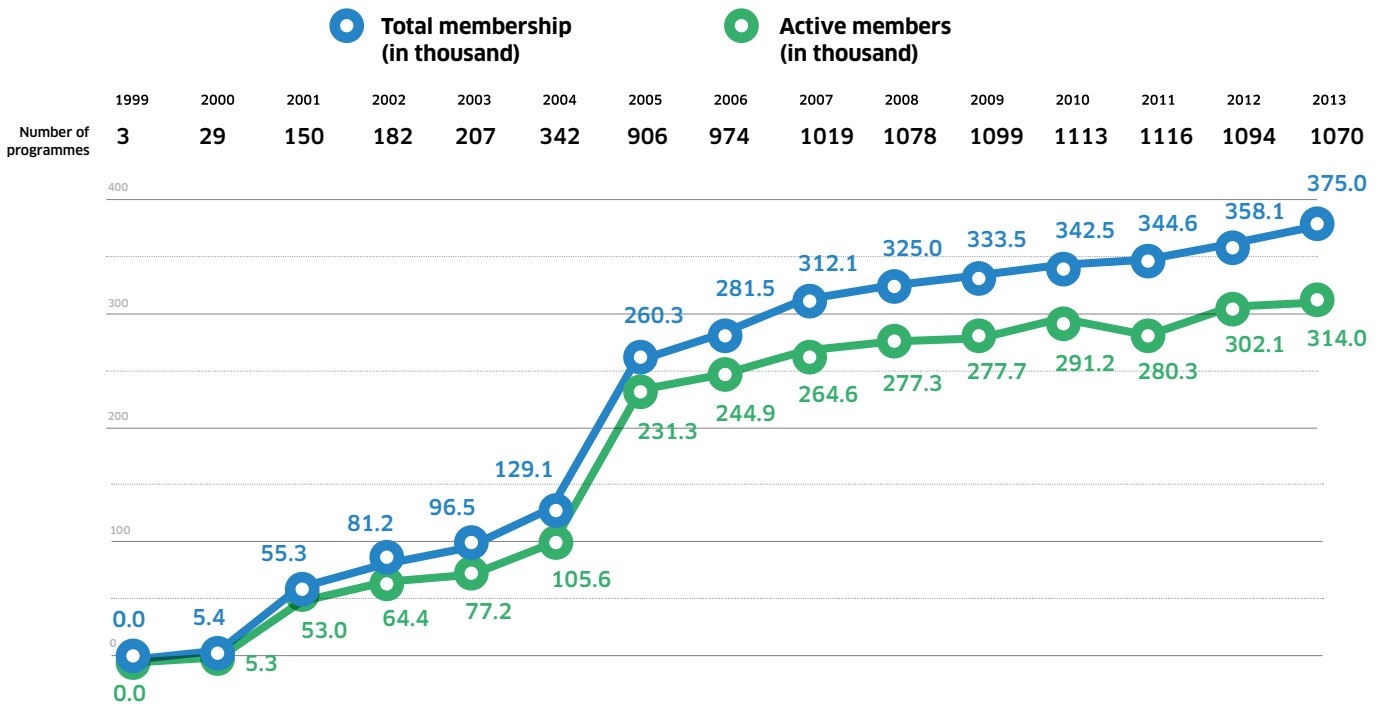


* For IKE and IKZE - number of accounts to which contributions were paid in the reporting period.

GRAPH 8

Number of PPE programmes and their membership in 2006, 2010 and 2013.

Source: Own calculations based on KNF data



those programmes (PPE, IKE, IKZE) in 2013 was approx. 630.000. **GRAPH 7** shows that successive schemes supported by the state (PPE – launched in 1999, IKE – launched in 2004, IKZE – launched in 2012) bring decreasing effects.

In PPE programmes in Poland regulations admit the possibility of combining the employee's and the employer's contributions. However, there are no effective incentives for employees to pay contributions at the expense of their current income. Hence the relatively few PPE programmes functioning in Poland are in practice based solely or almost solely on employer's contributions. The growth of the number of PPE programme members is very slow in recent years (See **GRAPH 8**).

In the case of IKE and IKZE schemes it is difficult to specify who they addressed to. IKE and IKZE are based on tax incentives which, as global experience shows, are not an effective tool to encourage those less well-off to save. In turn, the attractiveness of those schemes for well-off people is weakened by low annual contribution limits.

The system of preferences and limits in IKE and IKZE is not transparent and is difficult to understand for many potential members. Contribution limits are not rounded up and in practice are impossible to remember (for example: in the USA after indexation the limits are rounded up to USD 500, in the UK the annual allowance limits are rounded up to GBP 5 000 and lifetime allowance limits to GBP 50 000).

Parallel functioning of separate IKE and IKZE

schemes with similar names additionally decreases transparency of the system.

A problem, not always noted by members, are very high costs of fees charged by providers. In IKE and IKZE the total costs are on average 4 to 10 times higher than the average costs in OFE¹². The problem of high costs applies also to some PPE (programmes which are not run in the form of an Employee Pension Fund).

6. Poles do not behave differently from citizens of other countries in matters of pensions

A comparison of global and Polish experience indicates that, contrary to frequent popular opinions, Poles do not differ from citizens of other countries in their individual pension decisions. In other countries, like in Poland, it is mainly well-off people who save for their pensions, and promoting savings for the old age though tax incentives is in general ineffective in the case of people with low earnings. Universal participation is guaranteed by mandatory or quasi-mandatory savings schemes. In the case of voluntary systems a high percentage of participation is successfully achieved in some programmes to which employees are enrolled automatically, where opting out requires an active decision and at the same time there are clear financial incentives to remain in the system.

It can be argued that the low level of additional pension savings in Poland is above all the effect of the lack of appropriate institutional solutions. An attempt should be made to create such solutions.

4 Compare OECD (2012).

5 Compare World Bank (2014).

6 Average salary in 2012 amounted to NZD 51 300. See OECD (2013), p. 306.

7 NZ Herald (2011).

8 TVNZ (2013).

9 Samoń (2012), p. 22.

10 As above.

11 Rinaldi (2011).

12 See Capital Strategy (2013, p. 29).

CHAPTER 3

Goals and main structural elements of the proposed Programme

Goals of the Programme / 29

Main structural elements of the Programme / 29



Goals and main structural elements of the proposed Programme



Goals of the Programme

High level of employee participation, including a significant level of participation among employees with low income

We propose that the goal be to achieve a participation level over 80% in the total number of employees and no less than 70% among employees with salaries below the average salary in the economy.

Conversion of accumulated pension savings into annuities

The aim of the Programme should be to encourage the members effectively to convert the total or a significant part of their savings accumulated in the Programme into annuities. This applies in particular to people who have not secured for themselves a solid pension benefit from other sources.

Acceptable costs for employers

The costs for employers must be moderate so as not to undermine competitiveness of the economy and in order to reduce the risk that employers might discourage employees from membership in the Programme.

Limited costs for the state budget

The fiscal costs must be limited so that problems faced by the state budget should not become an obstacle to launching of the Programme and a reason of its dismantling in the future.

Conditions for members of the already existing Employee Pension Schemes will not deteriorate

Stability is essential for credibility of pension solutions.

That is why:

- a) The rights acquired by members of the already existing pension schemes in the 3rd pillar should not be changed.
- b) Employers and employees in the companies where Employee Pension Schemes were introduced on the basis of the to-date legal regulations should not find themselves in a worse situation than employers and employees in the companies where additional pension programmes will be introduced on the basis of new regulations.



Main structural elements of the Programme

1. Automatic enrolment

All employees in Poland will be automatically enrolled in the Programme by the employers. The solution applied in New Zealand can also be considered: at the start of the Programme the automatic enrolment might cover only the newly employed and the employees who change work.

The employee enrolled in the Programme will be able to decide to abandon the Programme in the period between the 2nd and the 8th week from the moment of the automatic enrolment, as well as in subsequent decision-making slots every four years.

2. Three sources of financing: employee's contributions, employer's contributions and budget subsidies (See INFOGRAPHIC)

EMPLOYEE'S CONTRIBUTION

The employee's contribution will amount to 1% of his

or her gross salary in the first year of the Programme and 2% starting from the second year.

EMPLOYER'S CONTRIBUTIONS - obligatory supplement to employee's voluntary contribution

If the employee participates in the Programme, his or her contribution is obligatorily supplemented by employer's contribution in the amount of minimum required percentage of the employee's remuneration. The employer's contribution will be: 1% of the employee's gross salary in the first year of the Programme and 2% starting from the second year.

SUBSIDIES FROM THE BUDGET

The employee's contribution and the employer's contribution will be supplemented with a budget subsidiary at a fixed rounded up monthly amount, e.g. PLN 40 monthly, but no higher than the employee's contribution.



Why PLN 40?

1. With this amount of subsidy, employees receiving salaries close to the minimum pay (which at present amounts to PLN 1680 and is proposed by the government for 2015 in the amount of PLN 1750) who participate in the Programme and pay contributions at the minimum required rate of 2%, receive the budget subsidy at 100% of the contribution paid by them. Therefore, the total pension contributions transferred to their pension accounts (from the employee's contribution, the employer's contribution and the budget subsidy) will constitute three times the value of the employee's voluntary contribution.

2. The amount is rounded up, easy to remember, and if multiplied by 12 months it gives the annual amount of the budget subsidy at PLN 480, that is approximately PLN 500.

3. Accumulating and investing of assets

3.1. Selection of asset manager

The employee's contribution, the employer's contribution and the budget subsidy are transferred to the employee's account in the pension fund run by the

manager selected by the employer, unless the employee decides to select another asset manager.

The choice can be made from among asset managers and funds licensed and supervised by KNF, offering standardized products approved by KNF.

The company managing a pension fund continuously collects information about the assets on the employee's account broken down into assets from the employee's contribution, assets from the employer's contribution and assets from subsidies, identifying on each of those subaccounts the benefits obtained as a result of exemption from capital gains tax, as well collects the information provided by the employer on the tax withheld from the employee on the employer's contributions.

3.2. Transfer of contributions

The ZUS should be responsible for the transfer of contributions. This would enable avoiding the need to create a special institution (and thereby to incur additional costs), as well as a reduction in administrative charges, which might be very burdensome, especially for small employers.

In the case of the existing PPE the employer may continue payment of contributions or pass on this obligation to ZUS.

3.3. Change of the employer

If the employee changes work, the new employer automatically pays the employee's contribution. The contribution is transferred through ZUS to the fund with which the employer concluded an agreement, unless the employee indicates another fund. If the employee was not previously a member of the Programme, he or she may decide to opt out from participation. If the employee is already a member of the Programme and accumulated contributions at the previous employment, he or she cannot opt out (otherwise than in the decision-making slot once in four years). If the employee moves to a new pension fund, he or she may choose one of two options concerning the assets accumulated in the previous fund:

- 1) order a transfer of the assets to the new fund
- 2) decide to leave the assets accumulated in the previous fund in that fund.

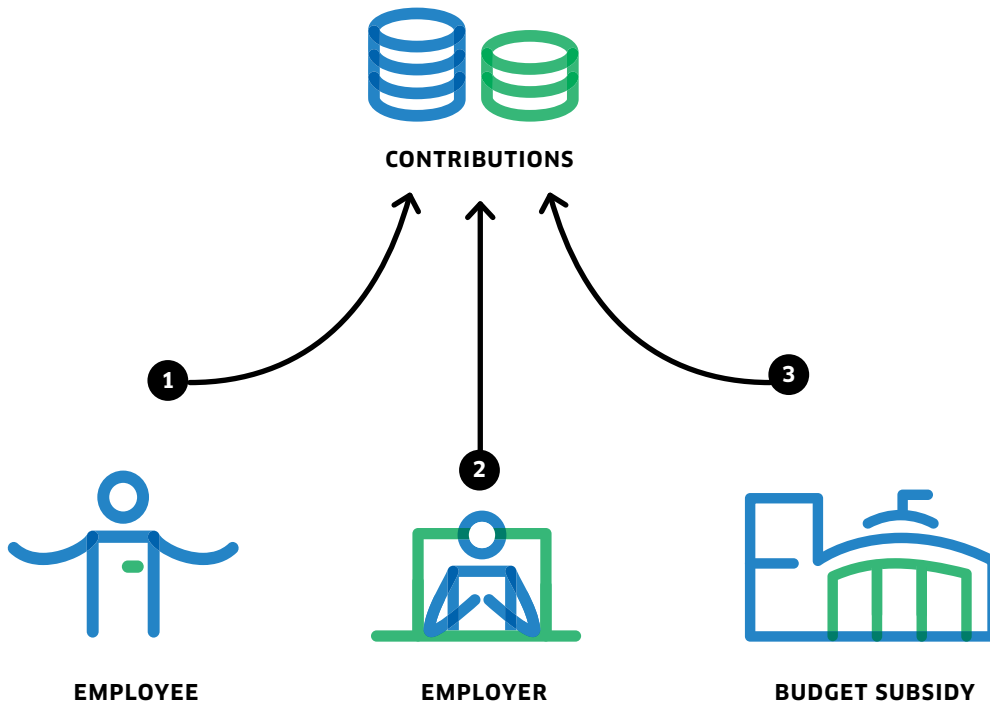
The second option is the default choice.

3.4. Cost limit

Considering that the system is universal, quasi-mandatory and uses budget subsidies, its costs must be under control and be moderate. The statutory threshold of fees charged on assets should not exceed 0.6% of the asset value, as is now the case with the Employee Pension Funds. The regulator would be authorized to

INFOGRAPHIC

Three sources of financing



First year

1%

of gross remuneration

1%

of gross employee's remuneration

The employee's contribution and the employer's contribution will be supplemented with a budget subsidiary at a fixed rounded up monthly amount, e.g. PLN 40 monthly, but no higher than the employee's contribution.

Following years

2%

of gross remuneration

2%

of gross employee's remuneration

reduce further the cost limit.

An appropriate distinction should be made between the fee charged by ZUS for transfer of the contributions and for a possible provision of other transfer agent services. It can be assumed that in the initial period ZUS does not charge fees for the transfer of the contributions or charges them at a minimum level.

3.5. Rules of taxation and charging with social insurance contributions

Proposed rules of taxation and charging with social insurance contributions in the case of the basic form of using the savings in the Programme, that is annuity, are presented in **TABLE 1**. The rules described in Table 1 may be presented with the symbols used in the literature on the subject, as shown in **TABLE 2**.



Why do we recommend the TEE system for the contributions?

1. The tax allowance on paid contribution directly decreases budget revenues, which increases the cost of the Programme. We believe that that budget subsidy is a more understandable and more effective incentive for employees than a tax allowance, especially for less educated people. If the force of the fiscal incentive is to be maximized with the given budget costs of the Programme, in our opinion, it is better to give up the tax allowance on the contribution and increase ceteris paribus the amount of the budget subsidy.

2. The TEE solution for contributions is applied in Employee Pension Schemes. Introduction of a different solution in the Programme would be an obstacle to the possibility of merging both programmes (which we propose below in section 9).

4. Resignation from further payment of contributions

If the employee in one of the decision-making slots decides to resign from further payment of the contributions, the accumulated assets will remain on the employee's account in the pension fund until the moment of his or her retirement.

When the employee decides to opt out from further

participation in the Programme, he or she may additionally make a separate decision to withdraw the assets accumulated from the employee's contribution.

5. Possibility to withdraw the assets before reaching the retirement age

Withdrawal of the accumulated assets from the Programme before reaching the retirement age may only apply to the assets from the employee's contribution (in total or in part). Then:

- a) The withdrawn amount is increased by the proportionate part of return on investment and decreased by capital gains tax.
- b) The proportionate part of the assets from the budget subsidy is cancelled – the corresponding amount is transferred to the state budget as its revenue.
- c) The proportionate part of the assets from the employer's contribution is transferred to the employee's pension account at ZUS.

6. Payments after reaching of the retirement age

6.1. Annuity – basic form of paying out benefits

The aim of the Programme is to encourage the employee to benefit from the accumulated savings in the form of a life-long annuity. At the moment of retirement, the employee may buy out such annuity in the selected benefit-paying institution, including also at ZUS.



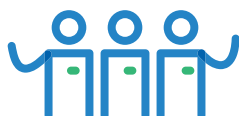
New product: “flexible life-long annuity”

In order to create more attractive conditions of converting pension savings into an annuity, we propose to introduce a special product: “flexible life-long annuity”, based on separate statutory solutions.

- The institution paying out the flexible life-long annuity will not incur the risk of longevity or risk of return rate on investment because their effects will be amortized by annual adjustment of the level of benefits for the entire cohort.
- A public institution – newly set up or set off within ZUS – should be responsible for administration and payment of the flexible life-long annuity.
- In the period of paying out the flexible life-long

TABLE 1**Rules of taxation and charging with social insurance contributions****EMPLOYEE'S CONTRIBUTION****EMPLOYER'S CONTRIBUTION****BUDGET SUBSIDY**

CONTRIBUTIONS	Paid from net remuneration (after payment of social insurance contributions and PIT)	Constitutes employer's tax-deductible cost and employee's taxable income, but social insurance contributions are not calculated on its basis.	Does not constitute employee's taxable income.
ASSETS ON ACCOUNT DURING THE INVESTING PERIOD	Exempt from the capital gains tax		
ANNUITY	Exempt from PIT Exempt from social insurance contributions		

TABLE 2**Rules of taxation and charging with social insurance contributions***(alternative form of presentation of the rules described in Table 1)***EMPLOYEE'S CONTRIBUTION****EMPLOYER'S CONTRIBUTION****BUDGET SUBSIDY**

PERSONAL INCOME TAX	TEE	TEE	EEE
SOCIAL INSURANCE CONTRIBUTIONS	TEE	EEE	EEE

TEE (Tax-Exempt-Exempt) means no exemption at the moment of paying in, exemption from capital gains tax in the investing period and exemption from charges (social insurance contributions) in the paying out period.

EEE (Exempt-Exempt-Exempt) means exemption from tax (contributions) in all three stages (that is at the moment of paying in, in the investing period,

and at the moment of paying out benefits).

EET (Exempt-Exempt-Tax) means exemption from tax (contributions) at the moment of paying in, exemption from capital gains tax in the investing period and no exemption from charges (social insurance contributions) in the paying out period.

annuity the assets would remain in the capital market and could be managed on outsourcing basis by private institutions selected in a tender by the institution paying out the benefits.

6.2. Other types of payments not resulting in the loss of fiscal privileges

At the moment of retirement the employee could pay out 25% of the accumulated savings and use the rest to buy an annuity.

As the aim of the Programme is to increase the socially unacceptable pensions, persons who obtained pensions and other annuity benefits for the total amount of at least 250% of the average pension may, after reaching the retirement age, freely dispose of their remaining assets under the Programme.

6.3. Cases of other disposal of the assets

After reaching the retirement age payments in the form or scope other than discussed above result in a loss of the assets accumulated from the budget subsidies along with the return on investment of those assets. The corresponding amounts will be transferred to the state budget as its revenue.

7. Including a part of the annuity in the minimum pension

The annuity paid out under the Programme, in its part from the budget subsidy and from the return on investment of those assets, will be included in the minimum pension, and will thus contribute to a reduction of future state budget subsidies to minimum pensions.

8. Inheritance

In the event of employee's death before receiving the annuity, his or her heirs inherit the assets on the employee's account from the employee's contributions and the employer's contributions. The assets from budget subsidies are not subject to inheritance and in such case they return to the budget.

Received annuity is not subject to inheritance.

9. Merger with the existing PPE schemes

If a company already has a functioning Employee Pension Scheme (PPE), under which the employer pays contributions to a pension fund, the contributions may be recognized as employee's contributions or employer's contributions under the Programme on the following rules:

- The employer's contributions in PPE may be recognized as the employer's contributions in the Programme in 1:1 ratio because these contributions

are treated in the same way from the perspective of taxation and social insurance charges.

- The employer's contributions paid under PPE may be recognized as the employer's contributions in the Programme with a determined discount of the order of 30% to compensate for the fact that, unlike the employee's contributions in the Programme, the employer's contributions in PPE are not charged with social insurance contributions.

In such case payment by the employer of the contribution in PPE at 4.86% of the employee's remuneration may be recognized as fulfilment of the obligation to pay employee's and employer's contributions in the Programme¹³. The employee receives the budget subsidy to the pension account (in the amount of PLN 40 monthly, but no more than 50% of the contribution paid) without the need to pay an extra contribution.

The rules of paying out the assets under the Programme are unchanged in the event of a merger with a PPE programme. This means that the employee retains the right to the assets from the budget subsidy only when the assets recognized under the Programme are converted into an annuity. After reaching the retirement age, the employee will be able to choose instead of the annuity the option of a one-off or instalment payment, as envisaged by the current regulations on PPE. But he or she will lose then the assets accumulated from the budget subsidies. Recognition of the contributions paid under PPE in the Programme will thus not deprive the employee of his or her rights guaranteed under the PPE scheme. But the budget subsidy will appear as a conditional bonus encouraging the employee to choose payment in the form of annuity.

10. Additional contributions

- The employee or the employer may at any time decide to pay an additional contribution (that is a contribution over the minimum required level) up to the maximum limits which are:
 - a) 7% of the employee's gross remuneration¹⁴ - for the employer's total contributions under PPE and the Programme.
 - b) 4.5 times the average salary forecasted in the national economy¹⁵ - for the employee's total contributions under PPE and the Programme.
- The additional contributions within the set limits benefit from the same tax rules as the basic contributions (in particular exemption from capital gains tax).
- Withdrawal of the assets from the employee's additional contributions before reaching the retirement age entails the obligation to pay the capital gains tax

on those assets, but does not cause a loss of the assets from the budget subsidy.

- Payment by the employee of the additional contributions does not cause a statutory obligation of supplementing them with additional employer's contributions (such commitment of the employer may, however, be contained in voluntary agreements within the company).

11. Membership in the Programme for persons who are not employees

Persons who are not employees in Poland, but who

reside in Poland or are Polish citizens, including persons residing abroad, will be able to participate in the Programme and benefit from some of its privileges on condition of paying the minimum contribution at 2% (1% in the first year of the Programme functioning) of the national average salary¹⁶. Such persons will not be able to count on the additional employer's contribution, but will receive the budget subsidy and will benefit from the exemption from the capital gains tax. The limits and sanctions related to those privileges will be as described above.

13 To consider the employee's obligation to pay 2% contribution under the Programme as fulfilled, the part of the employer's contribution at 2.86% of the employee's remuneration (with a 30% discount) will be required, the second part of the employer's contribution at 2% of the employee's remuneration will be recognized in the Programme as the 2% of the employer's contribution without any discount.

14 Limit for the employer's contribution determined in the act on employee pension schemes.

15 Limit for the employee's contribution determined in the act on employee pension schemes.

16 National average forecasted in the announcement of the Minister of Labour and Social Policy for purposes of calculating social insurance contributions.

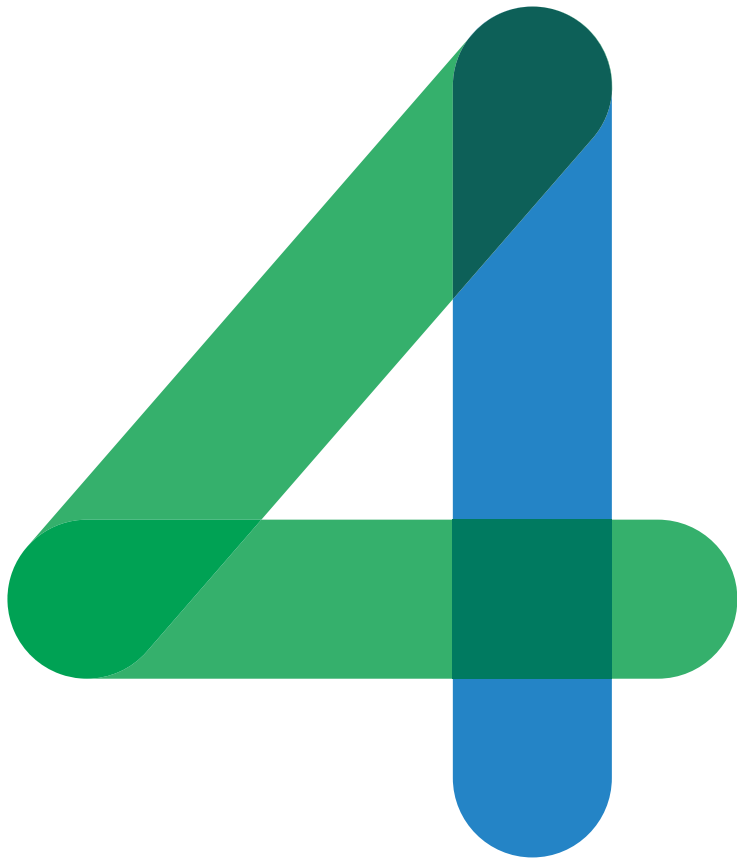
CHAPTER 4

Costs and benefits from the perspective of employees, employers and public finance

Costs and benefits from
the employees' perspective / 39

Costs for the employer / 39

Costs and benefits of the Programme
from the perspective of public finance / 42



Costs and benefits from the perspective of employees, employers and public finance



Costs and benefits from the employees' perspective

The proposed parameters of the Programme are particularly beneficial for employees earning up to PLN 2 000 gross: after tax, 246% of their lost current income will be transferred to their accounts in the pension fund. For the employees earning a salary close to the national average the ratio will be only slightly less beneficial. The limit earnings for the ratio of 200% amount to PLN 8 000 in the first year of the Programme functioning and PLN 4 500 in the following years. Although the attractiveness of the Programme decreases as the earnings increase, even for persons who earn PLN 30 000 monthly the ratio of the amount transferred to the pension account to the lost current income is very beneficial: 151% in the first year and 143% in the following years of the Programme functioning. Details are presented in the **TABLE 3**.

Impact on the pension level

For the employee who earns the national average salary the amounts transferred towards additional pension savings will amount to approximately 5% of gross salary vs. 19.52% transferred to the mandatory system. That means an increase the funds transferred towards future pensions by over 25%. Therefore, if the employee who earns the national average salary, participates in the additional savings programme throughout the entire period of employment, the total pension benefit of this person (from both mandatory and additional systems) may grow by over 25% gross if the total capital is dedicated to annuity. However, the employee may dedicate 1/4 of the accumulated capital for any other purpose (cf.

Chapter 3, point 6. Payments of benefits after reaching of retirement age). If the employee fully uses this possibility, thereby dedicating to the annuity only 3/4 of the accumulated capital, the total pension benefit of this person (from both mandatory and additional systems) may grow by over 19% gross. It is worth noting that in both cases the growth of the total net benefit will be a few percentage points higher than the net growth value, because unlike in the pension from the mandatory system, payments from the additional system will not be subject to taxation or subject to obligatory social and health insurance contributions. Assuming hypothetically that the effective tax rate on the pension from the mandatory system is 13%, the increase in the total net pension benefit (from both mandatory and additional systems) in the described case may be between 22% and 29%, depending on what portion of the capital accumulated in the additional system is dedicated by the employee to the annuity.



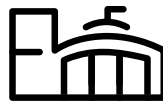
Costs for the employer

As the employer's contribution is not charged with social insurance contributions, the employer's contribution at 1% of the employee's gross salary will mean an increase by approx. 0.7% of the employer's cost of remuneration and benefits for a given employee.

Introduction of the Programme, with the participation at 80%, would mean the average increase of the company costs of remuneration and benefits for employees by 0.56% in the first year, and in the second year of the Programme an increase of those costs by another 0.56%, to the level of 1.12%, as illustrated in **GRAPH 9**.

TABLE 3
Costs and benefits for employees (monthly amounts)
Source: GUS

EMPLOYEE

EMPLOYER'S CONTRIBUTION

BUDGET SUBSIDY

TOTAL PAYMENT ON THE PENSION ACCOUNT AND ADDITIONAL CHARGES ON THE EMPLOYEE
IN THE FIRST YEAR OF THE PROGRAMME FUNCTIONING

	Employee's gross salary	Required employee's contribution in PLN	Amount of the contribution in PLN	Amount of tax paid by the employee in PLN	in PLN	As a ratio to the employee's contribution	Payment on the pension account in PLN	Total of employee's contribution and tax on employer's contribution	The ratio of the total payment on the pension account to the additional charge on the employee
	1 750*	17.5	17.5	3.8	17.5	100%	52.5	21.3	246%
	2 000	20.0	20.0	4.4	20.0	100%	60.0	24.4	246%
	3 000	30.0	30.0	6.6	30.0	100%	90.0	38.0	237%
	3 650**	36.5	36.5	8.0	36.5	100%	109.5	46.4	236%
	4 500	45.0	45.0	9.9	40.0	89%	130.0	54.9	237%
	6 000	60.0	60.0	13.2	40.0	67%	160.0	73.2	219%
	7 127***	71.3	71.3	15.6	40.0	56%	182.5	86.9	210%
	8 000	80.0	80.0	19.8	40.0	50%	200.0	99.8	200%
	10 000	100.0	100.0	29.2	40.0	40%	240.0	129.2	186%
	15 000	150.0	150.0	52.7	40.0	27%	340.0	202.7	168%
	30 000	300.0	300.0	123.3	40.0	13%	640.0	423.3	151%
	1 750*	35.0	35.0	7.7	35.0	100%	105.0	42.7	246%
	2 000	40.0	40.0	8.8	40.0	100%	120.0	48.8	246%
	3 000	60.0	60.0	13.2	40.0	67%	160.0	73.2	219%
	3 650**	73.0	73.0	16.0	40.0	55%	186.0	89.0	209%
	4 500	90.0	90.0	19.8	40.0	44%	220.0	109.8	200%
	6 000	120.0	120.0	26.3	40.0	33%	280.0	146.3	191%
	7 127***	142.5	142.5	31.3	40.0	28%	325.1	173.8	187%
	8 000	160.0	160.0	57.4	40.0	25%	360.0	217.4	166%
	10 000	200.0	200.0	76.2	40.0	20%	440.0	276.2	159%
	15 000	300.0	300.0	123.3	40.0	13%	640.0	423.3	151%
	30 000	600.0	600.0	264.5	40.0	7%	1 240.0	864.5	143%

IN THE SECOND AND FOLLOWING YEARS OF THE PROGRAMME FUNCTIONING

* The amount of the minimum monthly salary proposed by the government for 2015.

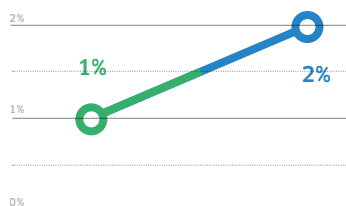
** Average salary in the economy in 2013 according to GUS.

*** The amount at which annual salary reaches the threshold of PLN 85 528, over which the PIT rate is 32%.

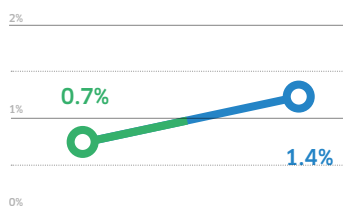
GRAPH 9
Costs for the employer

80% Expected membership of the employees in the Programme

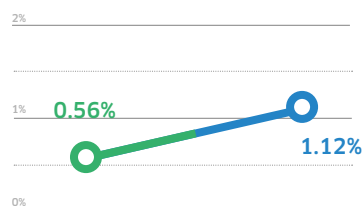
○ **FIRST YEAR**
○ **FOLLOWING YEARS**



Employee's contribution as a percentage of the remuneration of the employee participating in the Programme.



Employee's contribution as a percentage of the total cost of remuneration and social benefits related to employment of the employee participating in the Programme.



Employee's contribution as a percentage of the total cost of salaries and employee benefits in the company.

TABLE 4
Membership in the Programme

Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

GROUP	NUMBER OF PERSONS IN MILLION	PARTICIPATION	NUMBER OF PERSONS RECEIVING SUBSIDIES IN MILLION
EMPLOYEES employed on the basis of employment contract	9.72	80%	7.78
NON-EMPLOYEES IN THE PRODUCTIVE AGE (15 - 64 years), including:	17.33	7%	1.16
Receiving income only from a specific job contract or agency agreement	0.57	20%	0.11
Sole proprietorships:			
- contributions up to 60% of the average salary	0.28	10%	0.03
- contributions at 60% of the average salary	0.94	25%	0.23
- contributions over 60% of the average salary	0.01	80%	0.01
Other people in the productive age (15 - 64 years)	15.53	5%	0.78
TOTAL (persons in the productive age: 15 - 64 years)	27.05	33%	8.94



Costs and benefits of the Programme from the perspective of public finance

While assessing the effects of the Programme from the point of view of the public finance, the following should be considered in particular:

1) Impact of the Programme on the current result of the state budget, comprising the following elements:

- costs of the budget subsidies received by the Programme participants;
- reduction of revenue from CIT, as a result of charging companies with the obligatory employer's contribution (which will decrease their gross profit);
- revenue from PIT on the employer's contribution;
- cost for the budget resulting from the employer's contribution in the public sector.

2) Impact of the Programme on savings in the economy, in particular:

- Impact on growth of long-term pension savings;
- Impact on the total savings in the economy and on the country's International Net Investment Position.

3) Impact of the Programme on reduction of future subsidies to pensions in order to ensure the minimum pension level guaranteed by the state.

In sections 1. and 2. we estimate the factors mentioned in 1) and 2) above. We do not estimate here the factor mentioned in 3) because of the difficulty of making even a rough estimate based on the data available today.

1. Impact on the current result of the State budget

• Costs of the budget subsidies

The Programme members will be mainly employees, but it will also be open to non-employees (see Chapter 3, section 11). Our estimate of the number of the Programme participants in individual categories of persons is presented in **TABLE 4**. Generally, among the non-employees participation in the Programme will be significantly lower than among employees, because non-employees do not receive the incentive in the form of employer's contribution, and

additionally the mechanism of automatic enrolment does not apply to them. It was assumed that among the persons registered as sole proprietorships the participation will be higher in the groups paying higher ZUS contributions.

TABLE 5 presents estimated costs of the budget subsidies in the first and the following years of the Programme. In the first year the costs of budget subsidies will be lower because the employee's contribution will amount to only 1% of gross salary, and in accordance with the proposed rule the budget subsidy cannot exceed the employee's contribution (see Chapter 3, section 2).

The estimated amount of subsidies will account for 0.19 % GDP in the first year, and 0.25 % GDP in the following years annually.

• Reduction of revenues from CIT in connection with the mandatory employer's contribution

Charging the companies with mandatory employer's contribution will reduce their gross profit and thus will reduce the base for CIT taxation and revenues from this tax. The employer's contribution will not result in a reduction of the revenues from CIT in the case of employers who do not pay CIT, that is: employers from the budget sector and local governments, companies benefiting from tax exemptions or generating losses, as well as employers in the third sector. An estimate of the effects for the state budget is presented in **TABLE 6**.

• Revenue from PIT on the employer's contribution

An estimate of the revenues from PIT on the employer's contribution is presented in **TABLE 7**.

• Cost for the budget resulting from the employer's contribution in the public sector

With the participation in the Programme at 80%, the costs of employer's 2% contribution for the group of 3.4 million employees of the public sector (comprising all organizational units in which the State Treasury or local government own a stake greater than 50%), earning on average PLN 4019, to amounts to approx. PLN 2.6bn, which would account for 0.17% GDP (data for 2012). The amount could be theoretically considered as the upper estimate of full rolled cost for the public finance sector, resulting from the employer's contribution with the assumed level of employee participation in the Programme. We believe that in practice such estimate would be unjustified.

TABLE 5
Cost of budget subsidies (in 2013 prices)
Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

○ First year ○ Following years


**EMPLOYEES
employed on the basis of employment contract**

Number of persons receiving the subsidies in million	Average amount of the subsidy per person monthly/ annually	Total amount of subsidies in million PLN
--	--	--

7.78 mln	PLN 27 / PLN 324	PLN 2 520
	PLN 38 / PLN 456	PLN 3 547


**NON-EMPLOYEES
in the productive age (15 - 64 years)**

Number of persons receiving the subsidies in million	Average amount of the subsidy per person monthly/ annually	Total amount of subsidies in million PLN
--	--	--

1.16 mln	PLN 40 / PLN 480	PLN 557
	PLN 40 / PLN 480	PLN 557


TOTAL

Number of persons receiving the subsidies in million	Average amount of the subsidy per person monthly/ annually	Total amount of subsidies in million PLN
--	--	--

8.94 mln	PLN 29 / PLN 344	PLN 3 077
	PLN 38 / PLN 459	PLN 4 104

TABLE 6
Reduction of revenues from CIT in connection with the mandatory employer's contribution
Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

○ First year ○ Following years

Total annual amount of employer contributions in million PLN	3 407	6 814
Effective reduction of CIT taxable base*, in million PLN	1 703	3 407
Reduction of revenues from CIT	324 as a ratio to GDP 0,02%	647 as a ratio to GDP 0,04%

* it was assumed that because of the inclusion of the public sector, the existence of special economic zones and generation of losses by some companies 50% of employer contributions will influence the effective reduction of the CIT base.

TABLE 7
Revenue from PIT on the employer's contribution
Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

○ First year ○ Following years

Total annual amount of employer contributions in million PLN	3 407	6 814
PIT on employer contributions*	675 as a ratio to GDP 0,04%	1 350 as a ratio to GDP 0,08%

* it was assumed that 13% of contributions will be subject to 32% tax rate and the rest to 18% tax rate. Such assumption is not contradictory with the data contained in the information published by the Ministry of Finance concerning personal income tax settlement for 2013.

TABLE 8
Total impact of the Programme on the current result of the state budget (as % of GDP)
Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

○ First year ○ Following years

Impact on the result of the state budget

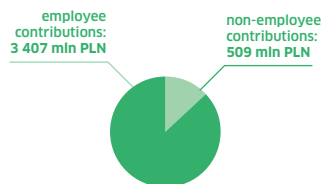
Budget subsidies for the Programme participants	- 0.19	- 0.25
Reduction of the revenues from CIT as a result of charging companies with mandatory employer's contribution	- 0.02	- 0.04
Revenues from PIT on employer's contribution	0.04	0.08
Cost for the budget resulting from employer's contribution in the public sector	-0.02 to -0.04	-0.04 to -0.08
Net effect for the budget	-0.19 to -0.21	-0.25 to -0.29

GRAPH 10

Assets on the Programme participants' accounts in pension funds

Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

FIRST YEAR



CONTRIBUTIONS OF THE PROGRAMME PARTICIPANTS

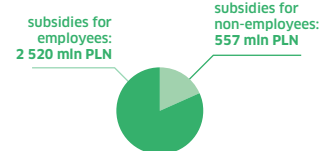
3 916

+



EMPLOYER CONTRIBUTIONS IN MILLION PLN

3 407



BUDGET SUBSIDIES IN MILLION PLN

3 077

=

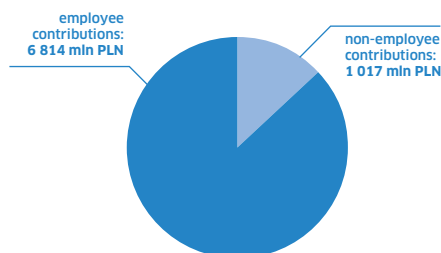
TOTAL IN MILLION PLN

10 400

as a ratio to GDP:

0.64%

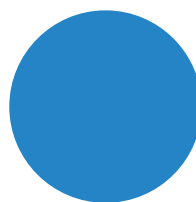
FOLLOWING YEARS



CONTRIBUTIONS OF THE PROGRAMME PARTICIPANTS

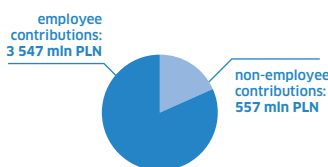
7 831

+



EMPLOYER CONTRIBUTIONS IN MILLION PLN

6 814



BUDGET SUBSIDIES IN MILLION PLN

4 104

=

TOTAL IN MILLION PLN

18 748

as a ratio to GDP:

1.15%

TABLE 9

Impact of the Programme on net savings in the economy annually starting from the second year (in billion unless indicated otherwise)

Source: Own calculations and estimates based on the data of ZUS and GUS for 2013

SECTOR	HOUSEHOLDS	BUSINESSES	BUDGET	ALL ECONOMY
TOTAL FOR THE ECONOMY SECTOR	14.2*	-6.2	-4.4	3.6 0.22% IN % GDP
INCLUDING	18.7 Total payment to the pension fund from employee's (member's) contribution, employer's contribution and budget subsidy. -4.6** Reduction in other forms of saving in connection with the transfer of some savings to the Programme. **50% reduction in the current income of households in connection with participation in the Programme (that is the total of the Programme participants' contributions and tax paid by employees on the employer's contributions).	-6.8 Employer's contribution. 0.6 Savings on CIT.	-4.4*** Net budget cost. ***Assuming 0.27% GDP from 2013.	

* The difference between the sum of components and the final total results from rounding off.

When in 2012 the government increased the pension contribution by 2%, it increased educational subsidy by PLN 450 000 000, which corresponded to 0.03% GDP. The chairperson of the Polish Teachers Association (ZNP) said, quoting calculations of local governments, that the cost of the increase was PLN 700 000 000¹⁷, that is 0.04% GDP.

We believe that in practice with the introduction of a 2% contribution for 80% of the employees in the process spread over two years it will not be necessary to make readjustments in the budget except for the above mentioned educational subsidy and possible some other special individual items. That is why we estimate the cost for the budget related to the employer's contribution at 0.02-0.04% GDP in the first year and 0.04-0.08% GDP in the following years.

• Total impact on the current result of the state budget

TABLE 8 presents a summary of the impact of the Programme on the current result of the state budget.

As follows from the data in Table 8, the total direct negative effect of the Programme for the state budget, starting from the second year of the Programme duration, can be estimated at net 0.25-0.29% GDP annually.

2. Impact of the Programme on savings in the economy

The Program will have a positive impact both on the total amount of savings in the economy and on their structure, increasing the share of stable long-term pension savings.

• Growth of pension savings

GRAPH 10 presents the growth of pension savings accumulated on accounts of the Programme participants. Annual growth of pension savings amounting to (starting from the second year) 1.15% will be approx. 4 times greater than the direct negative effect for the budget (See Table 8).

• Impact of the Programme on total net savings in the economy and Poland's INIP

The growth in pension savings as a result of the incentives used in the Programme is not identical with the growth of net savings in the economy. Budget subsidies and the employer's contribution generate the above mentioned costs for the state budget and for companies, which *ceteris paribus* will cause a reduction of savings in the public sector and business sector. In the case of households the growth of pension savings in the Programme will at a certain point be achieved at the expense of reducing the savings of the Programme participants kept in other forms. It should be expected that individuals, particularly those with higher income, will want to benefit from the incentives offered in the Programme and will place there some of their savings which otherwise would be deposited in other forms of saving. Persons with low income, who do not have savings that could be blocked for many years, will have to increase their net savings if they want to benefit from the privileges under the Programme.

TABLE 9 presents *ceteris paribus* the annual impact of the Programme on net savings in the economy, starting from the second year of the Programme duration, on the assumption that the reduction in the current income of households related to participation in the Programme (that is the total of the Programme member contributions and tax which the employees have to pay on the employer's contribution) will be amortized in 50% by the reduction of household savings outside the Programme.

The presented estimates show that the effect of the Programme will be a growth of net savings in the economy at 0.22% GDP annually¹⁸. This means *ceteris paribus* a positive impact of the Programme on the International Net Investment Position (INIP) of Poland in the same amount¹⁹.

¹⁷ Onet (2011).

¹⁸ Starting from the second year of the Programme duration. In the first year, with analogous assumptions, the Programme will bring a growth of net savings in the economy by 0.11% GDP.

¹⁹ Simplifying, it can be said that INIP is the effect of cumulated current trade balances. The value of balance on current trade accounts in suc-

cessive years is directly reflected in INIP changes. In accordance with the basic macroeconomic equation for an open economy, the balance on current account (CA) equals to the difference between savings (S) and investments (I), in other words: $CA=S-I$. A growth of savings (S) means *ceteris paribus* an improvement of the balance on current account (CA), which has a direct positive impact on the country's INIP.

CHAPTER 5

Proposals for IKE and IKZE

**Proposals for IKZE - enable transfer
from foreign pension schemes / 49**

**Proposals for IKE - increase
the payment limit / 50**

Integration of IKE and IKZE / 50



Proposals for IKE and IKZE

The proposals presented in this chapter concerning IKE and IKZE are to a large extent independent from the proposals regarding the Programme discussed in chapters 3 and 4 and essential for this Report.

In chapter 2 we noted that the IKE and IKZE programmes are not successful and do not achieve the goals for which they were created. However, a determined number of persons joined these programmes, treating them as a long-term saving offer. We believe that if we want the citizens to trust durability of the new programmes proposed by the state, it is necessary to avoid undermining the stability of the already existing programmes. That is why in our proposals which we submit for discussion, we focus on how to use the IKE and IKZE programmes reasonably rather than on how to eliminate them.



Proposals for IKZE - enable transfer from foreign pension schemes

As a result of EET taxation, the programme would be very expensive for the budget if it became successful. That is why at the moment when it was created a series of limitations was also introduced: initially the limit was calculated from the remuneration subject to contributions and payment was to be added to other income. In order to increase popularity of the programme, in 2014 changes were introduced, including a very attractive lump sum tax with payment at 10%. As a result, the main factor limiting the interest in IKZE are very low limits of

contributions, about PLN 4,000 annually. International experience suggests that in the case of a considerable increase of this limit²⁰ the rate of participation in the programme among taxpayers paying the highest PIT rate (32%) will grow dramatically, which in an extreme scenario would lead to an almost complete loss of tax revenues from income subject to this tax rate. That is why we do not recommend to increase the limit of annual contributions to IKZE.

A solution which will not undermine trust in pension schemes and at the same time will not increase costs for the budget is to leave the existing annual limit. Its rounding may be considered to make it easier to remember.

Transfer from EET-type pension schemes from other countries

With the EET taxation, one of the sources feeding the IKZE programme could be pension savings of Poles returning from abroad.

In capital funds in the world the common practice is not only the possibility of transfer to another fund in the event of changing the employer, but also the possibility of transfer to another country. In particular, the UK proposes such a solution. Savings accumulated in pension funds may be transferred abroad without any punitive tax only to funds from the list of qualified funds: Qualifying Recognised Overseas Pension Scheme (QROPS). Unfortunately, on the 61-page list of funds of October 2014, where in addition to very numerous funds from English speaking countries there are also funds from the Czech Republic, Hungary, Lithuania and Russia, there is not a single fund from Poland.

One of the requirements for a foreign fund to enter QROPS list is taxation of 70% of assets paid out. The conditions of taxation of assets paid out is fulfilled in IKZE. We propose to consider legislative changes which will lift limits in transfers of assets from foreign pension funds. This will enable creating under the IKZE programme funds which will be entered on the QROPS list.

The need to take such steps is confirmed by entries on internet forums indicating that Poles in the UK are considering transfer of their pension savings to Poland and are frustrated by the lack of such possibility²¹.

The proposal to convert IKZE into one of the possibilities to transfer pension savings from abroad is contradictory with the solution suggested by some experts consisting in introduction of a full exemption of payments from this programme. That is one of the arguments in favour of not exempting payments from IKZE from income tax.



Proposals for IKE – an increase of the limit of the amounts paid in

As experience from other countries shows, tax breaks do not bring a significant growth in savings nor do they increase the number of people saving. Their main effect is a transfer of savings. In the case of Poland two types of transfer would be desirable:

- a) Transfer of savings of well-off citizens home from abroad;
- b) Replacement of short-term savings with long-term ones.

Both the above goals could be achieved by increasing

considerably the limit of the amounts paid in annually to IKE.

TEE taxation applies to IKE. Payments to a scheme with the TEE system, unlike in the case of EET, do not generate current costs for the budget. That is why complete lifting of the limit might be considered, which would be in line with the scheme from the Netherlands²². Alternatively, the limit could be set at PLN 1 million annually.



Integration of IKE and IKZE

In order to reduce the administrative costs of IKE and IKZE, their merger might be considered.

It would be enough to create two subaccounts: EET and TEE.

It would be very convenient also for the participants because one agreement would be enough to participate in two schemes.

The integration would not change annual allowance limits, rules of transfers from abroad or rules of taxation.

In the event of integration of IKE and IKZE it is worth considering a reduction of the costs of functioning of both schemes.

²⁰ In the UK the limit of annual payments into pension schemes in the EET taxation system this year amounts to GBP 40 000. It is worth noting that in 2008 the limit was GBP 255 000, but because of budget problem was dramatically reduced in subsequent years.

²¹ Here are some examples of internet posts:

²¹ Gosia: Thank you for the article. I am precisely in such situation where I cannot transfer my contributions to Poland. When you write about a 55% tax on transferred amounts, what transfer is meant if in Poland as yet there is no fund accepted by the Revenue?
Source: http://londynek.net/wikipedia/article?jdnews_id=3421390

Braca: (...) Unfortunately I was not able to transfer my money to any pension fund in Poland because there is none on the list of the Department for Work and Pensions Website.

Source: money.pl (2014).

²² Under the scheme which has been in force in the Netherlands since 2015, pension contributions in the EET system can be paid on annual earnings up to 100,000 euros, while pension contributions in the TEE system can be paid without any limits on annual earnings exceeding 100,000 euro.

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Polish Chamber of Pension Funds (IGTE) is a business self-government organisation established in 1999. It represents the industry of Pension Insurance Companies (Powszechne Towarzystwa Emerytalne), institutions which manage Open Pension Funds and Voluntary Pension Funds. The Chamber associates 11 companies representing the interests of almost 16 million people. Members of the Chamber manage assets worth nearly PLN 150 billion, investing them mainly in the Polish economy. The Chamber conducts activity that supports the development of legislation conducive to an effective pension system, develops expertise in the area of pension insurance and capital market, builds relationships with stakeholders and presents the results of its work to the public.

www.igte.com.pl

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Polish economy suffers a deficiency of long-term domestic savings. At the same time future pensioners need additional capital for their old age in order to cushion the expected sharp decrease in the amount of pensions granted in the compulsory pension system compared with salary level. Poles, in their own best interest, should save for their pensions, which would simultaneously bring benefits for the country's economy. However the programmes of additional savings supported by the state enjoy little interest. Why do the Polish people not save for their pensions and act against both their own interest and public interest?