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11 Poland
Security through Diversity

Jerzy Hausner

The program for pension system reform launched at the beginning of 1997 in Poland was called by its authors "Security through Diversity" (Security 1997). This title emphasizes that pension reform—which is designed to guarantee security for the insured—must combine a first, pay-as-you-go (PAYGO) pillar; a second, mandatory, fully funded pillar; and a third, voluntary, funded pillar.

The beginnings of the pension system in Poland go back to the interwar period. It became a full-fledged universal PAYGO system in the 1950s. Since that time, the way it operates has not fundamentally changed. In the 1980s, the system came to cover the rural population as well. Each new measure, especially those adopted between the 1960s and the 1980s, involved granting additional privileges to different occupational groups. Nonetheless, until the end of the 1980s the system operated in relative financial equilibrium. This was possible due to—among other things—the gradual rise in the contribution rate. In the 1950s, it amounted to 15 percent of gross earnings, but by the end of the 1980s it had reached a level of 38 percent.

The financial insolvency of the PAYGO pension system in Poland is attributable to three sets of factors: those that are typical of modern societies in general and that are basically independent of the type of economic system; those that are specific to socialist and post-socialist societies; and those that are specific to Poland.

With respect to the first set of factors, society's aging, caused among other things by a fall in the birth rate and a rise in average life expectancy,

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has increased pressure on the system. Demographic waves, caused by population losses in World War II and the postwar demographic boom, also have created growing difficulties over time.

The ratio of pensioners to the working population, that is, the demographic dependency ratio (DDR), stood at 20.6 percent in 1985. Since that time it has increased, reaching approximately 23.8 percent around the year 2000. In the years 2000–05, the situation will improve slightly as increasing numbers of children of parents born during the postwar demographic boom reach working age. The coefficient will fall as a result to 23.1 percent. Then, however, those born during the postwar baby boom will themselves reach retirement age, after which the demographic dependency ratio will rise sharply, reaching 33.9 percent in 2020. In 1990, for every one person of retirement age there were 2.2 working persons. In 2005 this figure will be 2.1, but in 2020 it will fall to 1.8.

What this shows is that, compared to Western European societies in particular, the pressure of demographic factors is for the moment neither a major cause of tension in the Polish pension system, nor a major reason for its reform.

The main problem inherited from the socialist system is the pressure of branch interest groups characteristic of such economies. It is often said that a PAYGO system is susceptible to political pressures and bargaining. In socialist systems, where certain occupational branch groups (mainly in mining and heavy industry) gain excessive influence, this problem is particularly acute.

Among the factors specific to Poland are protection of the purchasing power of pensions during the transitional recession; the policy of fighting unemployment by facilitating early retirement; and lax legislation and entitlement regulations for disability status. The effect of all the causal factors mentioned above has been an increase in the total number of persons receiving pension benefits in the 1990s. In 1996, this figure was nearly 30 percent higher than at the end of the 1980s. On the other hand, between 1989 and 1996, the number of people employed and paying contributions dropped by 14.4 percent (Müller 1999, 5).

As a result, the ratio of persons receiving social insurance benefits to persons paying insurance contributions (the system dependency ratio [SDR]) has steadily increased. In 1995, the value of the SDR exceeded the value of the DDR by close to 40 percent. Poland's pension system was thus under severe strain and contributions have risen. At the beginning of the 1990s, the contribution rate was raised to 45 percent (31 percent according to net calculation), which means that Poland has one of the highest rates in the world—a fact that, owing to the country's unusually high indirect labor costs, is undermining the competitiveness of the economy. Despite the huge level of contributions, the Polish pension system is charac-

Table 11.1 **Expenditure on Disability and Retirement Pensions in 1990–96, and State Subsidies to Social Insurance Funds (FUS, KRUS) (as a percentage of GDP)**

Item	1990	1991	1992	1993	1994	1995	1996
Retirement and disability pensions	8.6	12.6	14.6	14.2	15.8	15.6	15.2
Social Insurance Fund (FUS) subsidy	—	2.9	4.3	4.2	3.9	2.1	1.9
Farmers' Social Insurance Fund (KRUS) subsidy	—	1.7	2.0	2.0	2.2	2.1	2.2

Source: Author's calculations based on Hausner (1998), 25, and UNDP (1997), 132.
Notes: Long dashes in columns indicate that the funds were not subsidized during that year.

terized by an especially high implicit pension debt[1]: approximately 220 percent of gross domestic product (GDP), significantly higher than in other transition economies (James 1998).

The general financial effect of the causal factors discussed above has been a dramatic increase in expenditure on pension benefits as a share of GDP (table 11.1). In the years from 1989 to 1995, it more than doubled. This will, of course, prevent any major increase in spending on other social services and investment in human capital, particularly because—despite the rise in the contribution rate—the social insurance system began to record a considerable deficit in the 1990s, which must be financed from budget subsidies.

Since the beginning of the transition there has been a growing awareness among experts and politicians of the need to reform the social insurance system. The first plans for a radical overhaul of the PAYGO system and the introduction of a funded insurance component appeared in the early 1990s. At the time, however, politicians did not give these plans due consideration.

If, then, they have in the end embraced reform, it is because it has proved difficult, ineffective, and ultimately impossible to carry out short-term preventive measures.

The rapid growth in expenditure on pension benefits, as well as the need to subsidize them heavily, put pressure on decision makers. The mechanism of backward-looking wage indexation for these benefits meant that, periodically, financial pressure sharply increased. This was reflected, above all, in the inability to prepare a budget that would avoid the dramatic choice between a huge rise in the budget deficit—thus undermining macroeconomic stability and reversing disinflationary trends—and major cuts in expenditure on important social and economic goals. The success-

1. The present value of the pension promises that are owed to current pensioners and workers because of their participation in the old system (James 1998, 459).

ful defense of macroeconomic discipline by successive ministers of finance meant that in practice there was no choice. From time to time it became necessary to weaken the benefit indexation mechanism. With the help of supplementary budget legislation, it was technically possible to limit the expected rise in retirement and disability pensions.

Such a course of action was, of course, opposed by pensioners and their representatives; it accordingly became a major political burden. This also explains the sharp fall in support for the post-Solidarity governments, and their eventual collapse in 1993.

The post-communist opposition, which won the elections while promising, among other things, a return to "fair" benefits, faced not only the same difficulties as before, but also new ones: The public protests had been accompanied by formal appeals to the Constitutional Tribunal. On numerous occasions the tribunal ruled in favor of those who had questioned the amended regulations. The new parliamentary majority could have formally overruled the verdicts of the tribunal, but in most cases it did not, feeling bound by its election promises. Thus the verdicts of the tribunal came into force, which led to an increase in financial pressure. The state's unpaid debts to pensioners rapidly grew, and came to form a significant portion of public debt.

In its rulings, the Constitutional Tribunal consistently recognized as unconstitutional the practice of periodically and temporarily suspending a portion of the state's commitments to pensioners for fiscal reasons. At the same time, it clearly stressed that this did not preclude the possibility of a permanent systemic change in the regulations, provided that such a change was preceded by appropriate legislation.

Thus, it was only when legal and political factors prevented *ad hoc* manipulation of the pension system that the warnings of experts and the idea of major reform came to be taken seriously.

Under the circumstances, a radical program for pension system reform in Poland had to be devised and implemented. It was based on the following principles:

1. *Full security.* The program must provide all age groups—pensioners (the grandparents' generation), long-time employees (the parents' generation), and beginning or prospective employees (the children's generation)—with a guarantee of economic security on termination of their working lives or in the case of inability to work.
2. *Protection of acquired rights.* Benefits acquired prior to the moment the appropriate new legislation takes effect must retain their real value—under the conditions of economic growth—for the rest of the holders' lifetimes, and will be paid in accordance with previous principles. Thus, the reform does not apply to today's pensioners.
3. *Individual prudence.* One of the foundations of the system's security

will be individual prudence, manifested through deliberate investment in the form of appropriate social insurance contributions that will translate into one's own future pension or disability benefits.

4. *A multisegment structure of the pension system.* High security of the system of pensions and disability benefits will result from its being based on three main pillars: PAYGO, funded, and voluntary insurance.

5. *Maximum freedom of choice.* Payment of the insurance contribution will be mandatory, as it is now, but one will be able to choose the pension fund in which to entrust one's savings, and it will be relatively easy to transfer saving from one fund to another. In addition, one will be able to decide (within certain margins) about the date of one's retirement.

6. *Transparency.* This will be ensured by the introduction of a universal system of individual social insurance records and accounts. In addition, pension funds must be obliged by law to publish information about their financial results.

7. *An active (regulatory) role of the state.* By regulating the functioning of the capital market and, in particular, supervising the operation of pension funds, the state should guarantee full security of the pension system.

8. *Sustainable and balanced economic growth.* The new system of pensions will utilize mechanisms of secure investment of funds.

These principles formed the basis for the introduction of the relevant legislation, which was adopted in two packages by two politically different governments and parliaments. The first package, submitted to Parliament in April 1997 by the center-left coalition (SLD-PSL), comprised:[2]

1. The Law (of 28 August 1997) on the Organization and Operation of Pension Funds,
2. The Law (of 22 August 1997) on Employee Pension Programs, and
3. The Law (of 25 June 1997) on Applying the Revenues from Privatization of a Portion of State Treasury Assets for Purposes Connected with Reforming the Social Insurance System.

The package specifies how revenue from privatization will be used to bridge the growing financial gap that has appeared in the present PAYGO pension system. In addition, it initiates reform of this system, and launches a second (mandatory) and develops a third (voluntary) funded pillar of pension insurance. It also fully regulates the organization and operation of second-pillar pension funds as well as the state's administrative supervision of their activities. Moreover, it lays down the rules determining how employee pension schemes—an entirely new and prospectively dominant form of voluntary, fully funded insurance—are to be set up and run.

2. "SLD" is the *Soljusz Lewicy Demokratycznej,* or the Democratic Left Alliance Party; "PSL" is the *Polskie Stronnictwo Ludowe,* or Polish Peasants' Party. For a detailed analysis of the work on pension reform during the SLD-PSL government, see Hausner 1998.

The second legislative package, prepared and submitted to Parliament in April 1998 by the center-right coalition (AWS-UW),[3] comprised:

1. The Law (of 13 October 1998) on the Social Insurance System, and
2. The Law (of 18 December 1998) on the new PAYGO pensions from the Social Insurance Institution (ZUS).

These laws specify the operation of the new first pillar and the ZUS, as well as the transition path from the old to the new pension system.

The new pension system in Poland was introduced on 1 January 1999, with changes to the PAYGO pillar. The launching of the second pillar was postponed until 1 April 1999 for technical reasons. The first pillar (PAYGO) retains five-eighths of the obligatory pension contribution (12.22 percent of gross wages). Although it remains a repartition-based scheme, its operation is governed by the principle of *defined contribution* (DC). The remaining three-eighths (7.30 percent of gross wages) of the contribution goes to the second (fully funded) pillar, composed of privately managed pension funds and also based on the DC principle. These two pillars make up the mandatory segment of the general pension system and are closely interconnected. All participants in the general pension system have their contributions and benefits calculated in accordance with the same rules. The amount of benefit depends exclusively—in the first pillar—on the aggregate amount of one's contributions (recorded in the individual notional account of every participant), the uniform rules of indexation, and one's age at retirement; and—in the second pillar—on the aggregate amount of contributions (likewise entered into individual capital accounts) and the efficiency of the investment strategy of a given fund. Payment of a minimum pension is guaranteed by the state to all participants in the general system (this can be seen as a kind of "zero pillar"). Participation in the third (funded) pillar is voluntary. The law allows for a variety of organizational forms and types of pension schemes in this segment.

Participation in the new general pension system is mandatory for all employed persons born after 1969 (i.e., aged under thirty). Persons born between 1949 and 1969 (aged from thirty to fifty) could choose between the "old" (exclusively reformed PAYGO) and the "new" system. Persons over the age of fifty were not allowed such a choice and must continue under the old system. The rules for calculating benefits will be unchanged for those retiring through 2006 (Chlon, Góra, and Rutkowski 1999, 15). The new principles do not apply in any way to persons who acquired pension benefits before the reform was launched.

Entitlements to pension benefits acquired under the previous system will be converted—for all participants to whom the new arrangements apply—

3. "AWS" is the *Akcja Wyborcza Solidarność* (Solidarity Electoral Alliance); UW is the *Unia Wolności* (Freedom Union).

into an "initial capital" in the new system. Additional contributions are transferred from the state budget for periods of national military service, nursing a disabled child, and parental leave. The Labor Fund covers periods of unemployment. These transfers are estimated at a level of 0.2–0.3 percent of GDP annually (Chlon, Góra, and Rutkowski 1999, 19).

In order to relieve pressure on the first pillar caused by demographic waves, a demographic reserve fund has been established. It will encompass any surplus in the first pillar plus one percentage point of the wage bill (about 0.35 percent of GDP) transferred to the fund in years 2002–08. The demographic reserve fund will invest its resources, and any interest or extra revenues will be added to the fund. It is estimated that the fund will account for approximately 14 percent of GDP by the year 2020 (Chlon, Góra, and Rutkowski 1999, 24).

Persons under the age of thirty, for whom participation in the new system is mandatory, had to choose their pension funds (within the second pillar) by 30 September 1999. If they did not make a choice, pension funds were assigned to them randomly by the Pension Fund Supervisory Board. Persons aged thirty to fifty could chose whether to switch to the new system. If they did so, they had to select their pension funds by 31 December 1999.

According to initial estimates, between 6 and 7 million participants were to enter the new general system (first and second pillars). The total possible number of entrants was 11.5 million, including 3.8 million born after 1968 (aged under thirty) and 7.7 million born in the years 1949–68 (thirty- to fifty-year-olds). By the end of 1999, 10.5 million people had joined the system, each choosing one of the twenty-one registered pension funds. Certainly, some of the agreements signed will turn out to be invalid (double agreements, forged agreements, agreements signed with persons not entitled to sign them). It is estimated that, on average, 15 percent of the agreements in the portfolio of each pension fund may be invalid. This has not decreased the considerable level of public interest in joining pension funds or the perceived success of the reform.

However, the situation of the various pension funds is highly diverse. Three are clearly dominant on the market: Commercial Union, Nationale Nederlanden, and Złota Jesień–PZU (see table 11.2). These are funds managed by insurance companies that have existed on the Polish market for at least a few years and that had a large network of experienced canvassers the moment they began recruiting. The clear losers have been the banks, who, with no such network at their disposal, have tried to attract clients through their local branches.

Thus, after the initial formation period, the level of concentration on the pension fund market—measured by the number of members and assets—is very high. The number of actual funds is also large, but many are too small to survive. Therefore, the trend toward rapid consolidation

Table 11.2 Ranking of Pension Funds (end of 1999)

Rank by Value of Contributions (end of 1999)	Value of Assets (in millions of zlotys)	Market Share (%)	Number of Members (× 1,000)
1. Commercial Union	678.9	30.2	2 million 300
2. Nationale Nederlanden	478.2	21.3	1 million 600
3. Złota Jesień–PZU	360.2	16.0	1 million 900
4. AIG	178.6	8.0	850
5. Zurich Solidarni	96.9	4.3	455
6. Norwich Union	75.5	3.4	565
7. Bankowy	74.9	3.3	390
8. Skarbiec-Emerytura	58.1	2.6	390
9. Winterthur	50.7	2.3	300
10. Ego	34.4	1.5	286
11. Orzeł	32.3	1.4	328
12. Dom	31.8	1.4	250
13. Allianz	30.5	1.3	197
14. Pocztylion	27.9	1.2	393
15. Pioneer	13.9		150
16. Pekao Alliance	10.0		70
17. Arka-Invesco	5.2		80
18. Epoka	3.2		100
19. Polsat	2.9		160
20. Kredyt Bank	1.6		90
21. Rodzina	0.2		75

Source: Polityka (2000).

on the market seems only natural. The companies managing the pension funds are in favor of such consolidation, although it is opposed—for the moment, only informally—by the Pension Fund Supervisory Board (*Urząd Nadzoru Funduszy Emerytalnych,* or UNFE). The board has also stated publicly that in its opinion concentration on the market is excessive. At the beginning of 2000, it published a controversial report for the government, in which it gave a negative assessment of the situation on the pension fund market and suggested amendments to the legislation regulating pension funds. The purpose of this was to slow down the consolidation process and to enable the high level of concentration to be restricted through administrative means. The board's proposal was fiercely opposed by those responsible for preparing and implementing reform of the pension system as well as by the companies concerned. Its authors were accused of trying to steer the market manually and hinder the free interplay of market forces.

Pension funds (in the second pillar) are required by law to diversify their investment portfolios. The ceilings for particular types of investment are as follows: shares in companies quoted on the stock exchange, 40 percent; foreign assets, 5 percent; secondary market securities, 10 percent; National

Investment Funds, 10 percent; and bonds issued by local governments, 15 percent. The actual structure of pension fund assets at the beginning of 2000 is illustrated in table 11.3.

The pension companies that manage pension funds have strongly emphasized a need that investment discipline, imposed on them by legislators, be eased. They believe that this would ensure a significantly higher rate of return, and in future a higher level of pensions. Their demands usually concern raising the ceiling on foreign investment and allowing investment on the real estate market. Of the opposite opinion is the UNFE, which has suggested the complete elimination of foreign investment. UNFE representatives justify this primarily by the need to ensure market security and to protect the saving of members of pension funds.

It should be stressed that the clear motive for reform of the Polish system is a desire to reduce the very high replacement rate (over 60 percent;

Table 11.3 The Structure of Pension Fund Assets (end of January 2000)

Fund Name	Bonds Issued by Treasury and by National Bank of Poland	Bank Deposits and Securities	Assets at the end of January	National Investment Funds
AIG	66.76	3.11	24.99	
Allianz	79.10	0.30	18.40	
Arka-Invesco	70.00	0.26	29.57	
Bankowy	58.20	1.14	31.14	
Commercial Union	64.88		34.27	
DOM	53.66		37.39	6.98
Ego	71.53	4.46	21.21	1.39
Epoka	84.40		9.72	
Kredyt Banku	77.30	8.11	8.11	
Nationale-Nederlanden	64.41	4.96	30.43	
Norwich Union	74.06	0.22	23.03	
PBK Orzeł	64.98	1.81	25.98	
Pekao/Alliance	56.37	5.20	36.44	
Pioneer	49.92	1.80	38.69	9.43
Pocztylion	66.12	0.88	31.32	
Polsat	58.51	2.67	33.86	2.45
PZU Złota Jesień	65.66	0.20	33.42	
Rodzina	69.52	4.70	18.82	
Skarbiec-Emerytura	66.12	6.88	20.00	
Winterthur	66.37	0.35	28.85	
Zurich Solidarni	76.04	0.02	23.71	
Total		Weighted average: 30.50		

Source: Rzeczpospolita (2000).

Notes: All amounts are percentages. The funds' remaining assets comprise dues from the sale of securities, cash resources, and investments below 1 percent of the value of assets. In addition, the following funds have invested assets in enterprise shares: Bankowy, 0.30 percent; PBK Orzeł, 3.74 percent; Pekao/Alliance, 1.92 percent; and Winterthur, 4.34 percent.

see table 11.4). However, such a move would not serve to reduce pension purchasing power. If reform restores solvency to the pension system and increases and consolidates economic growth—both indirectly (instead of financing the deficit of the Social Insurance Institution, budgetary resources would be used for structural policy and the creation of new jobs) and directly (through greater savings, a better financial capital structure, and thus a higher level of investment)—then a lower replacement rate will in future guarantee higher benefits than at present.

Because the main cause of crisis in the majority of post-socialist countries is not (for the time being) demography but a poorly managed PAYGO system, it is important to ask whether this system can be prepared and radical reform avoided. Theoretically, this is possible. Rationalizing and regulating the PAYGO system would restore long-term financial stability to the system. The problem could thus be adequately solved by raising the retirement age, eliminating occupational privileges, and abolishing early retirement.

This is how things look from a strictly financial point of view. From a political perspective, however, implementing such a program does not seem possible, for two reasons. First, it would challenge the vested interests of major social groups—in Poland, proposals to rationalize the present system sparked serious social protest and became a highly sensitive political issue. Second, the PAYGO system is by nature susceptible to political manipulation—certain groups can be guaranteed privileges at the expense of others because the relationship between contributions and benefits is unclear and ambiguous. The social insurance contribution is a collective tax and not a form of individual saving. Few people are aware of being insured, and thus the system lacks an institutionalized social force that could defend the interests of the younger generation who are inconvenienced by privileges that politicians find it more expedient to grant to older generations. In such a situation, politicians will always be tempted by moral hazard and will secure the votes of the large and active pensioner electorate by granting them undue privileges.

Polish experience in this area furnishes one example that should serve as a warning. Despite the acceptance by Parliament and government of plans for a new and universal pension system, attempts to exclude two influential legal groups from this system—judges and procurators—failed under pressure of political and parliamentary lobbying. The legal lobby had created a dangerous precedent. A new privilege was introduced, which limited the possibility of cutting back on existing privileges.

If, however, for doctrinal, practical, and political reasons a mixed system with a large PAYGO pillar is introduced (as in Poland), then the system can be protected from its natural susceptibility to political manipulation by individualizing social insurance, such as through a notional defined contribution (NDC). Individualizing social insurance can prevent

Table 11.4 Projected Replacement Rates in the New System (% of last salary)

	Retirement Age										
Pillar	60	61	62	63	64	65	66	67	68	69	70
First	21.8	23.2	24.7	26.3	28.0	29.9	31.8	33.9	36.2	38.7	41.3
Second	22.9	24.5	26.2	28.0	30.0	32.2	34.5	37.0	39.7	42.6	45.9
Total	44.7	47.7	50.9	54.3	58.0	62.1	66.3	70.9	75.9	81.3	87.2

Source: Chlon, Góra, and Rutkowski (1999).

permanent decay of the PAYGO system. Moreover, for society at large individualization is both desirable and understandable.

A difficult problem that needs to be addressed is the size of the second, fully funded pillar. Because members of younger age groups transfer part of their contributions to individual accounts in pension funds, the deficit in the PAYGO system is increasing. From this point of view it would be sensible to limit the number of people obliged or entitled to participate in the second pillar and reduce the size of the contribution assigned to this pillar. On the other hand, the operation of the pension funds entails specific costs that are undoubtedly higher than in the case of the PAYGO system. If there is only a small number of participants in these funds and they must cover the costs, this will considerably limit the size of accumulated capital and benefit payments. From this point of view, it would be necessary to do the opposite: to increase the number of participants in the second pillar as well as the level of contributions transferred to pension funds.

The choice must depend on the method adopted to finance the additional gap that will appear in the PAYGO pillar when the fully funded pillar is launched. In Poland, this fiscal gap—which should not be confused with the costs of reform—will be covered from current privatization revenue.[4] This is still possible due to the large amount of suitable state treasury assets that have not yet been privatized. At the same time, the capital market is sufficiently advanced (i.e., relatively large and efficiently regulated) to increase the scope of privatization and secure appropriately high revenues.

The "delayed" privatization in Poland (due to societal resistance to this process) turns out to have brought a significant, although to some extent accidental, benefit: The state treasury assets can now be used to support the pension system reform. This also accounts for the altered social perception of privatization, which no longer stirs up much controversy and is approved of by the greater part of society.

Privatization revenues appear an ideal source from which to finance the additional transitional fiscal gap within the pension system caused by its reform (see fig. 11.1). The direct use of these funds to offset the current budget deficit has the disadvantage of concealing the actual public-finance imbalance and allowing excessive expenditure to continue. When this transient source of financing eventually runs dry and cuts short the additional

4. As a result of introducing the mandatory fully funded pillar, an additional gap in the social insurance funds will appear for a certain transitional period (lasting at least several dozen years). In an economic sense, however, this is not an additional item of expenditure or a new liability, but the replacement of one form of public debt (implicit debt) with another (explicit debt). Consequently, the problem of liquidity becomes temporarily more acute within the system, but additional costs do not emerge if this additional gap can be financed without increasing the current budget deficit.

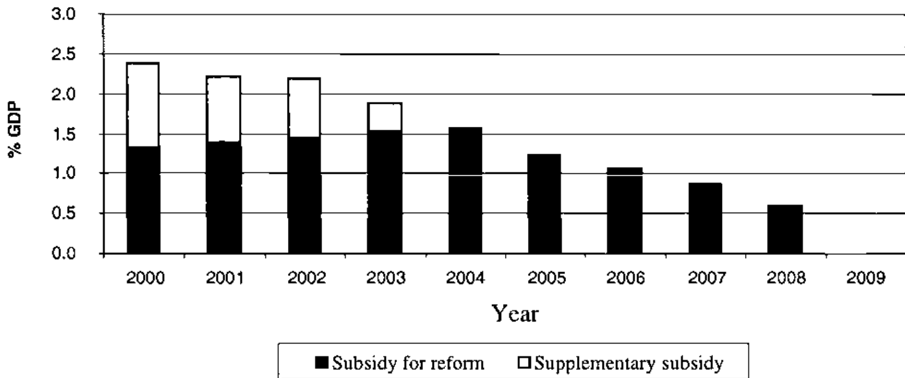

Fig. 11.1 Subsidy from the state budget to the social security fund (FUS)
Source: Chlon and Wóycicka (1999).

revenue stream, fiscal adjustment may prove extremely difficult and painful. To put it bluntly, rather than spend privatization revenues on consumption, it is far more reasonable to use them to finance the historic pension reform.

Another important factor is whether the economy in question is enjoying economic growth. If it is not, it is difficult to imagine obtaining revenue from privatization, while the investments of pension funds might not be sufficiently effective to ensure an increase in the capital of the participants in investment funds.

It is evident from the above that multipillar pension reform cannot be treated as a binding blueprint or a universal remedy. It is thus appropriate only for those transition countries experiencing economic growth and having a well-regulated capital market, a relatively balanced economy, and controllable budget deficits. Such countries should also have at their disposal efficient administrations capable of developing computerized information systems to deal with individual insurance records and ensure the swift and cheap transfer of contributions to pension funds and between different kinds of insurance. Ideally, they should also possess a large amount of state assets suitable for privatization. It is only under such conditions that a fully funded pillar will function, and only under such conditions that its implementation will stimulate economic growth.

The opinions of economists vary on this issue, because empirical research does not unequivocally confirm that capital (funded) insurance results in an increase in domestic saving. Even leaving aside arguments about the expected increase in domestic saving (which cannot be proved), it can be clearly shown that multipillar pension reform will accelerate economic growth as a result of changes in the capital structure. The establishment of pension funds is one of the relatively few fast-track methods of

long-term capital development in transition economies. Their appearance on a large scale will undoubtedly help reduce interest rates and thus investment costs, and as a consequence accelerate economic growth.

Currently, pension funds manage assets worth $US 750 million. Increasingly, they are investing these assets on the Warsaw Stock Exchange, which, in the opinion of many experts, contributed to the very sharp increase in share prices at the turn of 1999 to 2000. The Warsaw Stock Exchange index easily surpassed its record level from 1994. It is estimated that by 2005 the funds will be managing resources worth $US 4 billion and will become the largest investors on the Polish capital market.

The legislative framework of pension reform in Poland is still awaiting completion. So far, no attempt has been made to reform the separate pension system for farmers, which is managed by the Farmers' Social Insurance Fund (KRUS). This system is subsidized almost entirely from the state budget, at a level of 2 percent of GDP, and encompasses more than 2 million people.

In addition, the government has been unable to complete the very difficult negotiations over bridging pensions, which relate to early retirement for those who work in special conditions that may adversely affect health, or who perform physically and psychologically demanding work of a special character in the interests of public safety. Bridging pensions should be granted for the period between the earlier age at which working career ends and the minimum retirement age. Also needed is an annuity companies law, and a national actuary law that would establish a national actuarial office to supervise the long-term solvency of all social insurance programs.

The legislation on employee pension programs is not working, in practice. There have been very few applications to establish such programs, and the UNFE has dealt with them in a drawn-out and bureaucratic manner. Experts believe that in the light of experience to date, the legislation on employee pension programs should be amended. A private member's bill to amend the law was submitted to Parliament in the spring of 1999, but it is still in the process of being examined by a parliamentary commission. In actual fact, therefore, one of the pillars of the new system has so far not begun to function. This is significant to the extent that the reform envisaged a reduction in the replacement rate within the mandatory pillars and the establishment of attractive possibilities for additional voluntary insurance, ensuring a significant increase in the replacement rate for persons with high and medium incomes.

The initial reform project assumed a significant change in the retirement age. Formally, this age is sixty for women and sixty-five for men; in practice, it is roughly fifty-five for women and fifty-nine for men. The project envisaged the introduction of an elastic retirement age, which would in fact have been standardized for men and women—sixty-two in each case.

The center-right AWS-UW coalition abandoned this proposal in fear of public protest and under pressure from its Catholic faction, which, for ideological reasons, primarily attributes a family-oriented role to women. However, the retirement-age issue will certainly be debated again soon, for an actuarially fair benefit formula increases incentives to postpone retirement decisions (Chlon, Góra, and Rutkowski 1999, 19). At the same time, the introduction of this formula and the maintenance of a lower retirement age for women will mean that the benefits received by women will be significantly lower than those received by men, which will be seen as discrimination.

Currently, the main problem with pension reform in Poland is the organizational inefficiency of the Social Insurance Institution (ZUS) and the fact that this institution has failed to set up a comprehensive, computerized information system. The first and second pillars cannot operate without such a system, for it is then impossible to maintain individual accounts. The pension companies estimate that by the end of 1999 the Social Insurance Institution had transferred barely 50 percent of contributions to them, and that about 40 percent of members' accounts are dormant (i.e., not a single contribution has been paid in). Clearly, the problems of the Social Insurance Institution will not be resolved quickly. The new head of ZUS, appointed at the end of 1999, believes that resolution will be possible at the end of 2000 at the earliest. The inefficiency of ZUS also led to a major decrease in the contribution collection rate in 1999. Consequently, ZUS has run up an additional large deficit, which for the moment has been financed from bank credits; sooner or later, however, the taxpayer will have to foot the bill.

The example of the Social Insurance Institution clearly shows the extent to which reform of the pension system is dependent on the efficiency of the public administration. In Poland, the efficiency of the administration is still very low and is further decreased by the practice of filling key public positions according to political (party) criteria. This practice is also responsible for the poor functioning of the Social Insurance Institution and the Pension Fund Supervisory Board, two key public institutions on whose efficiency the success of pension reform rests.

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