THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

Changes in Poland's Transfer Payments in the 1990s: The Fate of Pensioners

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Working Paper Number 148
April 11, 1998

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The Fate of Pensioners

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1. Introduction

Only seven years ago, Poland's centrally planned economy afforded its citizens a cradle to grave embrace of health care, housing, education and employment. The price exacted for these benefits, though, was high and, in many respects, all encompassing. In the political arena, that price included almost complete political disenfranchisement and a system in which no elected institutions held the state responsible for its economic and other policies.

Fittingly, in 1990 Polish socialism was toppled from the "bottom up" by the very popular consensus that it had worked so hard to repress since the end of World War II. Faced with a crumbling state owned economy, the newly elected government moved quickly towards privatization, implementing the now well known "shock therapy" program of economic reform.

Besides a new economy, however, Poles also awoke to a new relationship between popular consensus and government policies. Our purpose here is to discuss that relationship as it affects privatization through the prism of government spending and, more specifically, by quantifying and assessing government spending as a percentage of GDP during the years 1991-1996.

The notion underlying this approach is that the marketization process should diminish such spending over time, consistent with a growing private sector. However, the opposite process is occurring in Poland. That is, despite fundamental changes in the mechanisms of that country's economy, government spending has actually increased as a percentage of total GDP during the examined period

Because that increase appears to have been driven largely by popular resistance to deeper social welfare cuts, we conclude that the "honeymoon" phase of Polish reform may be over, and a new, much more sporadic phase of transition may have already begun.

2. Analysis of Changes in Government Spending in the 1990s

Government spending has two components: transfers and purchases of goods and services. Transfers are defined as government payments to different societal groups based upon criteria unrelated to their current productive economic activity, such as age or income. Pensions, welfare payments, and unemployment benefits are examples of transfer payments. Government purchases directly absorb or employ resources, and the resulting production is a part of domestic output.

In table 1, both components of government spending are quantified as a percentage of Poland's GDP for the years 1991 - 1996. From table 1 we see that despite fundamental structural changes in Poland's economy, the GDP percentage attributable to government spending actually increased by fully 4.6 percentage points. Moreover, despite fluctuations by year, the distinct trend has been an increase in that percentage over time.

Table 1 Government Spending as a share of GDP in percent

year	1991	1992	1993	1994	1995	1996
G/GDP	29.9	33.2	32.3	32.7	31.6	34.5

Source: Calculation based on Statistical Yearbook, 1996, Small Statistical Yearbook, 1997, Public Finance, Owsiak Stanislaw, Wydawnictwo Naukowe PWN, Warsaw, 1997, p. 379.

These aggregate spending figures are disagregated into categories of government expenditures, per year, in table 2. Because these spending categories overlap (e.g., pension benefits are officially reported in both the "subsidies" and "state firms" spending categories), they exceed 100 percent when aggregated in any given year. The ability to make relative comparisons of expenditures by category between years is, however, unaffected by this overlap.

Table 2 Government Spending, By Category, as a share of GDP

year	1991	1992	1993	1994	1995	1996
subsidies	40.5	40.5	38.7	40.1	34.7	36.7
FUS	9.1	12.9	13.1	13.3	15.1	18.1
KRUS	6.6	6.6.	6.7	7.3	7.3	7.4
State firms	9.1	5.2	3.9	3.2	3.0	2.3
Education	11.6	10.3	10.3	11.2	11.3	4.8
Hger Education	2.7	2.6	2.5	2.3	2.4	2.7
Health	16.1	14.9	14.2	13.8	14.4	15.3
St. Administr.	2.9	2.7	3.2	3.4	3.4	3.6
Police	3.5	3.8	4.1	3.9	3.7	2.6
Nat. Security	7.4	6.6	6.5	6.0	5.8	5.5
Agriculture	3.5	2.3	2.4	2.3	2.1	
Banks	4.1	5.1	3.3	3.1	2.2	2.3
Debt (a) service (b)	1.1 3.0	5.6 3.1	8.8 2.4	10.7 2.7	12.2 3.6	10.1 3.1

Source: Calculation based on Statistical Yearbook, 1996, Small Statistical Yearbook, 1997, Public Finance, Owsiak Stanislaw, Wydawnictwo Naukowe PWN, Warsaw, 1997, p. 379.

Notes:
FUS -- social insurance fund for non-agricultural workers
KRUS -- social insurance fund for agricultural workers
Debt (a) -- domestic
Debt (b) -- foreign

Because our concern is with those government expenditures that are the most likely to mimic public sentiment regarding reform, the analysis excludes the national security, police, state administration, debt, and education[1] spending categories. Of the remaining items, the most numerically significant spending category during the reported period was "subsidies," which also has the widest coverage and includes such items as pension fund contributions, infusions of money to unprofitable state enterprises, and price supports for agricultural inputs (i.e,. fertilizers).

Growth in subsidies has been negative, registering a 3.8 percent decline from its 1991 level, though increasing 2 percentage points from 1995 to 1996. In general, this overall decline is partially attributable to the privatization of many state enterprises and the diminishing subsidization of others which, as a percentage of all government spending, declined from over 9 percent in 1991 to approximately 2.3 percent in 1996.

Both the government's privatization efforts and its reluctance to bail out failing state enterprises has, however, been selective. In particular, payments to the coal mining industry have increased, in relative terms, from 22.8 percent to some 73 percent of all government subsidies to state enterprises during the examined period. Moreover, the high level of subsidization to this

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[1]. Parenthetically, government expenditures on education declined from 11.6 to 2.3 percent of GDP between 1991 and 1996. This steep decline was caused not by privatization as such, but rather by the central government's delegation of revenue raising to local governments, effective as of January 1996.

industry is unlikely to change anytime soon.

This conclusion is based upon several factors. To begin with, under central planning, Poland's heavy industry development was highly concentrated by region. In Silesia, coal mines were developed to the exclusion of most other types of industry. Subsequent, piecemeal attempts to diversify that region's economy have failed, and no comprehensive plan to provide employment alternatives has yet been proposed. Silesia therefore remains dependent on the coal mining industry. Unfortunately, these same coal mines are saddled with antiquated equipment, operate with bloated work forces, and endure one of the worst safety records in Europe. As a result, these mines are grossly inefficient and unable to mine coal at below world market prices, rendering them exceedingly poor candidates for privatization.

Meanwhile, Poland's miners, who enjoyed a unique status under socialism as a vanguard of the proletariat, were also critical players in the Solidarity movement who remain united, well-organized, and favorably regarded by the larger population. As such, miners have been able to exert sufficient political pressure on Poland's successive governments to exempt mines from the financial accountability imposed on many other state enterprises, and have also prevented the state from diminishing the burden of mining on the central budget by delegating even a portion of those fiscal responsibilities to regional governments. Consequently, Poland's mines remain state owned and continue to bleed the state budget.

Pensions are another critical category of government spending. The current pension system was formed in 1954, when the state assumed sole responsibility for all pension benefits. Since its inception the pension system has been managed by two state institutions, Kasa Rolniczego Ubezpieczenia Spolecznego (KRUS), which is responsible for the pensions of Poland's private farmers, and Fundusz Ubezpieczen Spolecznych which administers all other pensions except those of "strategic" or "uniformed" workers (e.g., the police, military, and custom officers). Under this system there are three major types of pensions: retirement, disability and family.

In general, pensions are funded from two sources - the state, and mandatory contributions by future beneficiaries, if employed. Most FUS participants contribute a percentage of their annual salary to the pension fund, while KRUS contributions were flat, but have recently been modified to better reflect the income of individual farmers.

Pensions benefits take two forms: monetary and non-monetary. Monetary benefits are based on the previous salary and position of a particular recipient and are therefore unique to that recipient. By contrast, non-monetary benefits are uniformly granted to all former members of a particular economic sector or profession (e.g., discounted fees for different services).

The eligibility criteria for benefits differ by type of pension. The distinct trend, though, has been to make pensions available to more people at higher benefit levels.

In absolute terms the government's increasing role in this area is even more pronounced. The amount of money contributed by the state to fund pension benefits rose by 725 percent between 1990 and 1995, representing fully 15 percent of Poland's total state budget in that year.

The state's annual share of pension contributions as a percentage of all benefits paid has also risen dramatically. For KRUS, 93.8 percent of pension benefits paid in 1995 were funded by the government, as compared with 89.4 percent in 1991.[2] For ZUS, the state's growing role in funding benefits is even more dramatic - rising from 18.9 percent in 1991 to 36 percent in 1995.

There are several reasons for these extraordinary growth rates in state spending levels. Primary among them is that in the 1990s each of Poland's successively elected governments viewed the pension system as a safety valve for economic reform. Anticipating widespread downsizing, rapid privatization and unemployment, the state consistently lowered retirement ages and narrowed the gap between pension benefit levels and the wages of fully employed

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[2]. Pension benefits for farmers likely play a meaningful role in the composition of Polish agriculture. In particular, farmers often pass land ownership rights to their children, take retirement pensions, and use their current pension benefits to supplement the income of extended families. This supplement is needed because farms under 3 hectares typically earn only 17 percent of their annual expenditures through farming. Not until a farm reaches 7 hectares do earnings from farming exceed the average farmer's pension, but 68 percent of Polish farms are below that size. On such farms, pension benefits support, on average, an additional 23 percent of expenditures. Undoubtedly, then, many farm families depend upon the pension benefits of parents or grandparents to survive. In this manner, the pension system actually hampers the restructuring of Polish agriculture by supporting small and inefficient farms.

state workers. In agriculture, pension beneficiaries were exempted from paying KRUS contributions and, for the disabled, pension access was also substantially expanded by relaxing eligibility requirements.

As a result almost one quarter of the Polish population were pensioners by the mid-1990s. The growth rates of each group of benefit recipients is set forth in table 3, which reveals that the number of retirees, disabled, and family pensioners grew by some 37.3 percent, 20.2 percent and 13.3 percent, respectively, between 1990 and 1995.

Table 3 Growth in number of of persons receiving benefits (excluding private farming)

Year	retirement	disability	family
1990	100.0	100.0	100.0
1993	130.9	114.2	107.5
1994	134.1	117.4	110.4
1995	137.3	120.2	113.3

Source: "Wazniejsze Informacje z Zakresu Ubezpieczen Spolecznych," "Important Information Regarding Social Safety Net," ZUS, Department of Statistics, Analysis and Forecasting, Warsaw, March 1996.

Having intentionally "grown" the pool of pensioners, the state also raised pension benefits to preserve purchasing power through various indexation schemes and benefit calculation methods. Rather than simply maintain the status quo, these policies have increased the value of some pensions faster than increase in real average wages. This pattern is also a continuing one, as average real pension growth exceeded average real wage growth by 1.2 percent in the first three quarters of 1997.

At present, numerous economic reforms of Poland's pension system are being debated. Several of these reforms would increase pension benefits, while others are focused more on the formation of private pension funds. Although the contours of the eventual solution to this budgetary crisis are as yet unknown, it bears mention that pensioners now constitute 23.8 of Poland's total population, and an even higher percent of the electorate. At the same time, Poland's dependency ratio is 1.6 workers per pensioner (as compared to more than 5 to 1 in the United States) and working Poles now contribute, on average, 45 percent of their wages to fund the pension system.

Given these rather stark numbers, it seems unlikely that the pension problem will be resolved through either decreasing benefits to pensioners or shifting funding greater funding responsibilities to working Poles. Instead, at least in the short term, the more likely scenario is that state contributions will continue at very high levels.

Notably, not all categories of government spending have increased as a percentage of GDP since 1991. The third largest spending category in Table 1, medical services, is state run and accounted for roughly 15 percent of all government spending throughout the examined period. One primary reason for this apparent holding pattern is that most Poles simply cannot afford to purchase private health care at market prices, and the state cannot afford to increase the quality of that care.

Given this fundamental dilemma, it is difficult to see how a consensus for widespread privatization would emerge and, to date, it has not. No systemic reforms concerning health care funding have been proposed, and the state has instead opted for a patchwork of cost containment measures that hinge largely upon holding down the salaries of health care providers, imposing marginal user fees on prescription drugs, and limiting certain types of care.

Like medical services, government expenditures on higher education as a percentage of GDP have remained stable between 1991 and 1996. Arguably, Poles seeking higher education are the best able of all the state's client groups to succeed without subsidization. Nevertheless, the bulk of Poland's colleges and universities remain state administered and funded. Two factors working directly against privatization in this sector are the desire to keep higher education accessible to all socio-economic groups and strong resistance among academics, many of whom were active in the Solidarity movement and have remained influential in setting government policies during the 1990s.

By contrast, government expenditures on banking and agricultural expenditures have decreased as a percentage of GDP during the reform period. Regarding banking, the decline from 4.1 to 2.3 percent of GDP is the result of privatization, bank consolidations, and government assistance, all of which have contributed to reducing the percentage of nonperforming loans.

For agriculture, government spending as a percentage of GDP declined from 3.5 to 2.1 percent between 1991 and 1995. Aside from the previously discussed funding for farmer pension benefits, though, most government aid to farmers is in the form of trade barriers, not direct subsidies, which have always been relatively small.

3. Conclusion

It is self-evident that, in a democracy, government policies which fundamentally alter the fabric of everyday life will be formed, in part, by public reaction to them. In Poland, we have seen this proposition borne out.

Having committed itself to rapid privatization and reform, Poland has not experienced a decline in government expenditures. Instead, since 1991 government spending as a percentage of GDP has substantially increased in absolute terms and, in certain key categories, has increased in relative terms as well. Moreover, government increases in particular spending categories have coincided with populist pressure, and this same pressure can be identified where the GDP share of other spending categories has remained either relatively stable, or failed to decline in an economically rational manner.

What this developing, and demonstrated, linkage between consensus and economic policy means for the future of Polish reform remains unclear. On the one hand, it is apparent that marketization has successfully taken root in Poland, and that the transition process is largely irreversible. On the other, the ultimate beneficiaries of these reforms, Poland's electorate, most recently placed in power a government dominated by AWS (Akcja

Wyborcza Solidarnosc), which is a party that stands for increased government benefits to different to social groups and the extension of many state subsidies.

What is certain, though, is that as Polish society matures economically, it is also maturing politically, and that the linkage between popular consensus and government economic policy can only increase. In a sense, then, the "easy" part of shock therapy is ending, and the "hard" part now begins.

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