

S t u d i a i A n a l i z y *S t u d i e s & A n a l y s e s*

*Centrum Analiz
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Barbara Liberda

Household Saving in Poland

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This paper was prepared for the research project "Sustaining Growth through Reform Consolidation" No. 181-A-00-97-00322, financed by the United States Agency for International Development (US AID) and CASE Foundation.

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Graphic Design: Agnieszka Natalia Bury

DTP: CeDeWu – Centrum Doradztwa i Wydawnictw "Multi-Press" sp. z o.o.

ISSN 1506-1701, ISBN 83-7178-183-0

Publisher:

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Abstracts

Household Saving Rate in Poland

The author estimates determinants of household saving in Poland in years 1994–1997. It turns out that the household saving rate depends strongly on household income. However, the household saving function from disposable income is not strictly linear. It "kinks" upwards at the point where household income is 1.5 times higher than the average income. The saving profiles of households in Poland partially resemble those that would follow from the life cycle theory.

Costs and Benefits of the Pension System Reform in Poland – the Impact on Savings

The ratio of beneficiaries to contribution payers in Poland is 2.5 times higher than the ratio of population of retirement age to economically active people and 1.5 higher than the ratio of average retirement lifetime to average working lifetime. Such a situation gives rise to very high costs of the former pay-as-you-go (PAYG) system in comparison to fully funded systems. The author compares model costs of both systems over the horizon of next 30–40 years and forecasts an equalisation of the above ratios by about 2030. The impact of the pension system reform on savings will depend on many counteracting factors.

Part I. Household Saving Rate in Poland*

I. Definitions and Macroeconomic Data

Creation of a market economy in Poland considerably changed the saving behaviour of all economic agents. At a macro scale it meant changing the structure of national saving accumulated by major sectors of the economy: households, corporate sector and government (public sector). Structure of national saving has changed due to the differences in the growth rates of the main sectors of the economy, as well as to the differences in the saving rates of these sectors.

In the national accounts the aggregate saving is the balancing item in the disposable income account. Saving is defined as a difference between disposable income of a given sector and its consumption [1]. Thus, saving is a part of the disposable income that is designated to increase the existing stock of wealth. Saving may be positive or negative. Positive saving may either increase assets or reduce liabilities. Negative saving means that either some financial or non-financial assets must be liquidated, or the cash balance is going down, or the liabilities are rising.

Table 1 presents the structure of national domestic saving in Poland. National domestic saving rose from some 16% of GDP in 1991 to 21% of GDP in 1997. This increase has in part been caused by a more precise adjustment of the national product figures for the unofficial (grey) economy from 1994 onward. Better coverage of the grey economy in national accounts raised the national saving rate by 3 percentage points. Before the recalculating of GDP the domestic saving rate for 1996 amounted to 18% of GDP. If the national accounts for 1991–1993 were also recalculated, the saving rate in those years would probably be higher by 1–2 points. In sum, the increase of the national saving rate during the years 1991–1997 is of a 2–3 points magnitude, rather than of 5 points. It shows that the saving account, as a residual item, reflects too strongly both the errors of estimation of the GDP, and the changes in accounting methodology.

Recalculation of the GDP for 1994–1997 caused the most visible changes in the estimates of households' saving. Households' saving from the household disposable income has risen, in relation to previous calculations for 1994–1996, by 2–2.5 points. Because GDP has been re-adjusted by some 6 points in each of the years of 1994–1997 (Rachunki 1991–1997, 213), the households saving rate in proportion to GDP, as a result of the two re-

* I am grateful to Professor Brunon Górecki for giving me access to the households budget survey data.

[1] Consumption takes place only in households, government and non-profit institutions.

Table 1. Saving rates in Poland in years 1991–1997 (by major sectors, in percentage)

	1991	1992	1993	1994	1995	1996	1997
Household saving rate out of disposable income	16.3	15.0	12.5	13.7	16.0	12.9	13.2
Household saving in GDP	11.5	10.9	9.0	9.9	11.5	9.2	9.5
Corporate saving in GDP	7.2	6.8	6.9	9.4	9.0	10.1	9.7
Private saving in GDP	18.8	17.7	15.9	19.3	20.5	19.3	19.2
Government saving in GDP	-2.9	-2.3	-0.1	0.8	0.8	1.5	1.8
National domestic saving in GDP	15.9	15.4	15.8	20.2	21.4	20.9	21.0
Share of household saving in private saving	61	62	57	51	56	48	49
Share of household saving in national domestic saving	72	71	57	49	54	44	45

Source: Rachunki narodowe według sektorów instytucjonalnych 1991–1997, GUS, 1999

calculations, rose by 1.3–1.8 point in each year. It turns out that the bulk of the grey economy activities pertaining to saving has been attributed to the households sector.

In years 1991–1997 the structure of private saving changed. Share of the corporate sector in creation of private saving rose, while the share of households fell down from 60% to 50% of total private saving. The private sector has not raised its contribution to the national saving (which remained at a level of 19% of the GDP). The national domestic saving rate rose due to an increase in government (public) sector saving. The household saving made up for a decreasing share of total domestic saving (a fall from 70% to 45% in years 1991–1997).

The aggregate data on households saving tend to blur the differences in the saving rates of different groups of households. Thus, they cannot serve as a basis for economic policy geared to increase the propensity to save.

2. Determinants of Household Saving

In order to specify the determinants of household saving, the households should be viewed at a micro scale and the data collected must be representative for all households. Such data are collected in Poland every year in the household surveys done by the Central

Statistical Office. Despite all the drawbacks, these data represent the richest source of information on households.

Personal saving should be observed during the whole life span of an individual. For that purpose data on saving behaviour of the subsequent generations in their respective life cycles should be examined. According to the life-cycle theory, personal consumption is smoothed out in the life cycle, and savings constitute the difference between the smoothed out consumption and the varying income. Savings are negative or very low in younger households, when incomes are below the expected life-cycle level. Savings rise with age when incomes are above the forecast life-time income level. The peak of savings, which according to the life-cycle theory are collected mainly for financing consumption after retirement, takes place in the age of 60–65. Theoretically, when a person does not obtain any income, the accumulated wealth is consumed. In reality, persons aged 65 and more (retirement age) report positive savings, too. The better a person is able to foresee her/his path of growth of a life-time income and the more stable (permanent) this income is, the lower may be the saving rate of this person.

The life-cycle savings depend mainly on demographic factors, like age, size of the family, time of arriving of the first child etc. They also depend on many factors connected with demography: education, place of living, source of income. The sum of these factors has impact on a current income of an individual and of a household [2]. These factors also influence expectations of the future income. Combination of demographic, social, and income factors is a basis of the inter-temporal choice between consumption and saving.

There exist, however, many factors that are not explicitly taken into consideration in the life-cycle theory, but which markedly influence the households' saving. The life-cycle theory assumes high certainty of expectations of future incomes and a high level of understanding and rationality of the inter-temporal choice by individuals. However, these conditions often do not hold. Uncertainty validates the precautionary motive of saving (protecting against income shocks).

The structure of the social security system (retirement plans and health care) can deform the planned profile of consumption and saving. It is mainly the case when the social security systems guaranteed by the state rise in importance [OECD, 1995; Liberda, 1999].

Bequest motive does not concern all households. In economic theory, bequest is considered a luxury good.

A growing rate of economic and professional activity of women can, paradoxically, cause the saving rate of their families to fall. There may occur, then, an increase of the

[2] The life-cycle theory concerns an individual in her/his life-time, but the life-time income is spent also for providing for the family. Most of data, however, describe a household during the life-time of the household's head.

consumption expenditures substituting for a product made previously by women in the households. The precautionary motive is also weaker due to higher certainty of incomes. Also, the retirement insurance of employed women may lower other elements of family savings [Attanasio, Banks, 1998].

The consumption and life patterns of subsequent generations differ considerably. It makes difficult to forecast the life-time saving profiles of young generations on the basis of the profiles of their parents. For example, the baby-boom generations and even younger yuppies differ from the previous generations not only in income levels but, mainly, in size of the family and in postponing of the decisions on saving as well as on having children for the later periods of their life-cycles.

Economic policy concerning saving (income tax policy, taxing of capital gains, etc.) may also change and deform the life-time profiles of saving of individuals [Honohan, 1995].

Development of financial markets lengthens the horizon of consumption planning by removing the liquidity constraint. But it can also have a negative impact on saving (e.g. falling into a credit card trap or participating in consumption credits booms).

Still, all these factors cannot explain high saving rate of high-income persons above 65 years of age, who are not lead by bequest motive or are childless. A different pattern of saving function of the richest (as compared to the rest of the society) can be explained by a hypothesis that they treat saving as a luxury good generating a stream of special services, like power, social status, etc. [Carroll, 1998].

This paper aims at specifying the main demographic, income and social determinants of the households saving rate in Poland in the 1990s.

3. Microeconomic Data

The author uses full data set of the Households Budget Surveys in Poland for the years 1994–1997 and for year 1988. On average, about 30 thousand of households were surveyed each year. The household saving is defined as net households lending (balance of savings deposits and credits taken) and households housing investment (building of apartments and real estate plus housing renovation). The household saving rate is calculated by dividing monthly savings by the household monthly disposable income.

In years 1994–1997 and in 1988 the housing investment of households constituted about 2–3% of the household disposable income. Thus, the household saving rate calculated in this paper is higher as compared to other estimates of household saving that

treat saving as net lending only. This was the rule in Polish literature, but not elsewhere [Deniszczuk, 1998, Poterba, 1994].

Table 2 presents the saving rates of households grouped according to various criteria (age, family size, sex, income group, education level etc.) in 1997. The medians of the household saving rates, as well as the values of the rates for the first and third quartiles of households in each group are given. Generally, the saving rates for the first quartile of households in each group (except for the three top income deciles) are negative. It gives the average saving rate for the bottom quartile of households of (minus) 8.8%. Then, the saving rates of the third top quartile of households are 2–3 times higher than the median for all households. In 1997, half of the households saved less than 10% of their disposable income, and the top quartile more than 27%. The following characteristics of the households' saving can be inferred from Table 2.

Table 2. Household saving rates in 1997

	1 quartile 0.25	Median 0.50	3 quartile 0.75	Number of observations
Total	-0.088	0.101	0.273	31776
Sex of household head				
Men	-0.073	0.114	0.286	21126
Women	-0.113	0.076	0.246	10650
Household type by source of income				
Employees	-0.054	0.119	0.278	13188
Employees-farmers	-0.058	0.138	0.316	3057
Farmers	-0.345	0.062	0.376	1691
Self-employed	-0.067	0.099	0.278	1978
Retirees and pensioners	-0.102	0.082	0.255	10821
Unemployed	-0.25	-0.007	0.141	1041
Size of family				
One person family	-0.146	0.042	0.214	4288
Two person family	-0.093	0.103	0.28	7618
Three person family	-0.07	0.112	0.284	6709
Four and more person family	-0.073	0.112	0.28	13161
Income groups				
1 decile	-0.459	-0.076	0.108	3177
2 decile	-0.248	-0.008	0.155	3178
3 decile	-0.17	0.039	0.2	3178
4 decile	-0.119	0.054	0.212	3177
5 decile	-0.09	0.079	0.242	3178
6 decile	-0.047	0.109	0.264	3178
7 decile	-0.031	0.134	0.283	3177
8 decile	0.008	0.168	0.311	3178
9 decile	0.048	0.201	0.353	3178
10 decile	0.11	0.293	0.479	3177

Table 2.

	I quartile 0.25	Median 0.50	3 quartile 0.75	Number of observations
Education				
Primary	-0.115	0.088	0.274	8621
Vocational	-0.079	0.105	0.276	10406
Secondary	-0.082	0.102	0.268	8956
Post-secondary	-0.097	0.099	0.253	951
Higher (tertiary)	-0.063	0.118	0.283	3202
Age				
18-24	-0.648	0.117	0.308	894
25-29	-0.068	0.13	0.311	1992
30-34	-0.069	0.123	0.294	2750
35-39	-0.101	0.097	0.264	3780
40-44	-0.106	0.08	0.253	4704
45-49	-0.081	0.102	0.269	4406
50-54	-0.076	0.119	0.273	2930
55-59	-0.096	0.093	0.27	2357
60-64	-0.104	0.092	0.27	2443
65 and more	-0.089	0.099	0.276	5520
Property				
House	-0.119	0.11	0.301	12567
Flat	-0.062	0.101	0.266	7187
Car	-0.082	0.112	0.285	13233
Computer	-0.079	0.115	0.287	2745
Place of living				
Towns above 20 thousand inhabitants	-0.077	0.099	0.262	17227
Villages and towns below 20 thousand inh.	-0.106	0.103	0.246	14549

– Saving rates are the highest in households headed by young persons (aged 18–34) and in the group aged 50–54 (Fig. 1).

– Saving function by age has got two peaks instead of one, which, according to the life-cycle theory, takes place generally in the age soon before retirement. Thus, the age profile of the saving function in Poland is not in accord with the life-cycle theory for the younger age groups. In the years 1994–1997 the age saving function has become better fit to the model for the older age groups (Fig. 2a). The age saving function for 1988 is even less matched with the model for the younger age groups. For the older age groups it shows falling of the saving rates after retirement, which is in accord with the simplified version of the life-cycle model (Fig. 2b).

– A peak of saving before retirement takes place in Poland about 10 years earlier than in other economies. It is probably connected with the lower effective age of retirement

Figure 1. Median saving rates by age groups in 1997

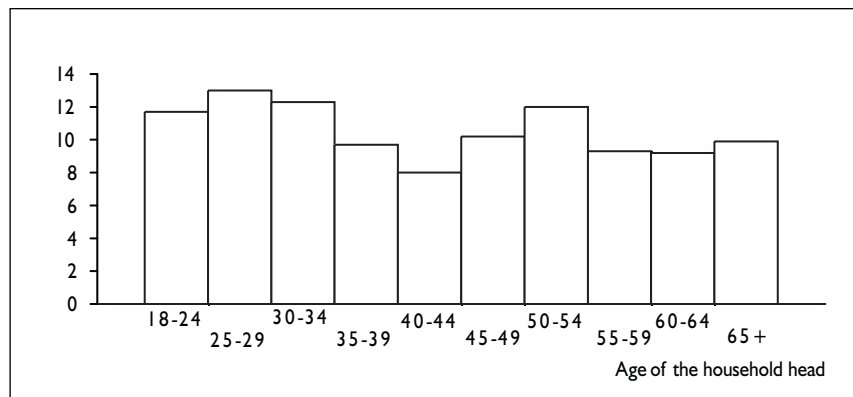
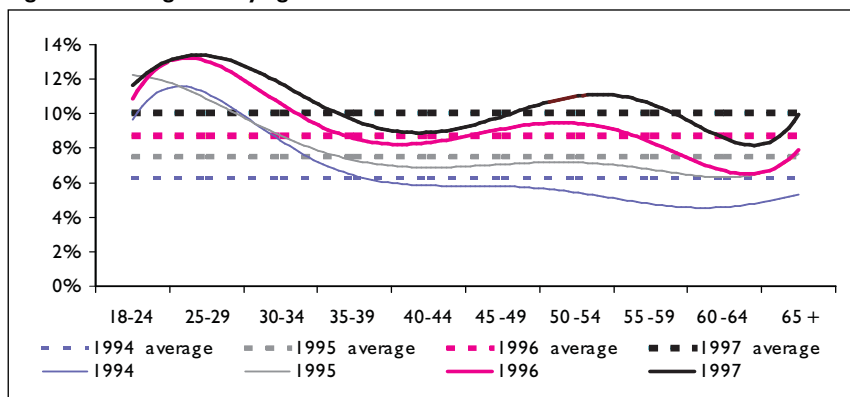


Figure 2a. Saving rates by age in 1994–1997



in Poland, which, on average, is 57 years (55 for women and 59 for men) [Liberda, 1999].

- Saving rates are positively correlated with the number of persons in a family. This trend is similar to the features of the less developed economies and differs from the more developed economies [Schmidt-Hebbel, Webb, Corsetti, 1992; Poterba, 1994].

- Persons with higher (tertiary) education save the highest percentage of their incomes. In the second place there are persons with vocational education (Fig. 3).

- The saving rates of households headed by women are lower by one third than the

Figure 2b. Saving rates by age in: 1988 and 1994–1997

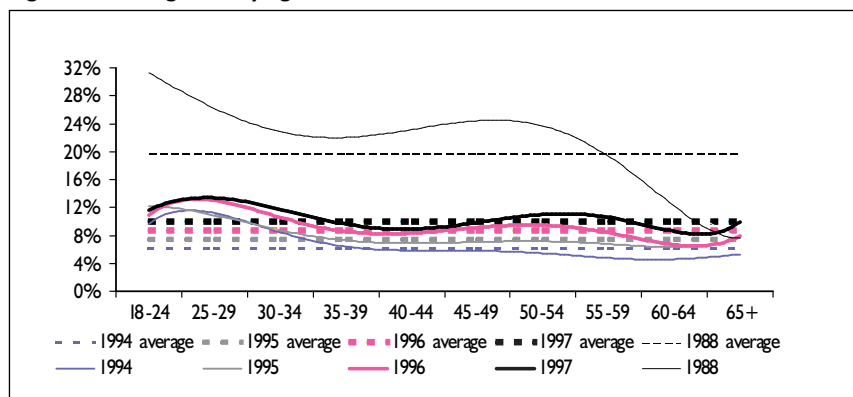
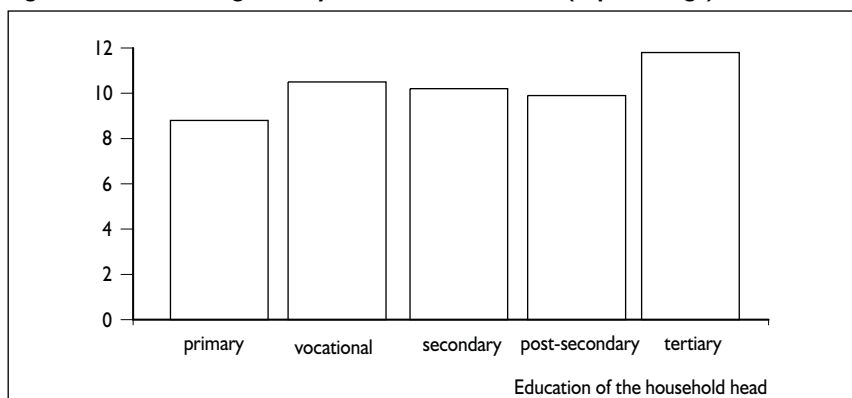


Figure 3. Median saving rates by education level in 1997 (in percentage)



saving rate for household headed by men. In Poland, women are the main income provider in one third of households.

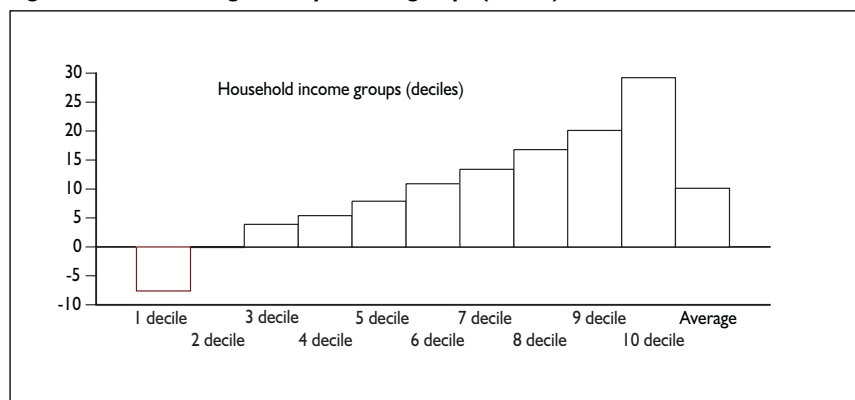
– Saving rates are highest in households of employees and in households with mixed sources of income (employment and farming). Farmers have the lowest rate, while the self-employed save at the average rate (Fig. 4).

– The household saving rate in Poland is strongly dependent on income (Fig. 5). More than three thirds of gross household saving is created by two top deciles of households.

Figure 4. Median saving rates by source of income in 1997 (in percentage)



Figure 5. Median saving rates by income groups (deciles) in 1997



The 9th decile collects of 18% positive savings and the 10th decile makes 59% of all savings. The top 5% of the households create 45% and the top 1% of households accumulate 24% of all household savings.

4. Saving Function of Households in Poland

The saving function from disposable income has been estimated on a basis of data for 100 income groups of households. Each group consist then of 1% of all households.

The linear trend of saving from disposable income for all households is very steep (marginal propensity to save from disposable income was 0.44 in 1997) (Fig. 6a).

Because of the big difference between the saving rates of two groups of households: the bottom one (consisting of 7/8 of all households with incomes below 1.5 of average income) and the upper one (consisting of 1/8 of all households with incomes above 1.5 of average income) the saving function has been approximated as a kinked-function (Fig. 6b).

The following function has been estimated:

$$y = b_0 + b_{ID}(x - x_0)\xi + b_{IG}(x - x_0)(1 - \xi)$$

where:

x - household income in zł

y - household saving in zł

x_0 - the border income dividing 7/8 and 1/8 of households

$$\xi = \begin{cases} 1 & \text{for } x < x_0 \\ 0 & \text{for } x > x_0 \end{cases}$$

b_0, b_{ID}, b_{IG} - structural parameters of estimation

In 1997, the marginal propensity to save (MPS) of the bottom group was 0.27 and MPS of the upper group was 0.59. In 1994–1997 the MPS of the lower group was growing (from 0.21 to 0.27) and the MPS of the upper group oscillated around 0.60 (Fig. 7).

The saving function for 1988 is steeper in both stretches of the "kinked" function. These very high marginal propensities to save for both groups of households in 1988 probably reflect the scale of forced savings in the economy of shortage [3]. It is interesting that the share of housing investment in household income in 1988 (about 2%) was not different from values for 1994–1997 (2–3% of household incomes). A boom of buying flats at prices very much lowered by inflation was to come only in the years 1989–1991.

High saving rate of young households in 1988 was determined by high savings of farmer households, as well as mixed households (farmers and employees). They saved more than 35% of income. It was a sign of shortages on the market of agricultural

[3] Not fully comparable with the above is the estimation of a propensity to save for the employee households for 1973 by Topińska (1986). The marginal propensity to save in a bank (except cash held at home) from disposable income was 0.15 in 1973. But the beginning of the 1970s was characterised by a relative decrease of shortages on the consumer goods market made possible by imports.

Figure 6a. Linear trend and the "kinked" saving function in 1997 (savings out of household disposable income)

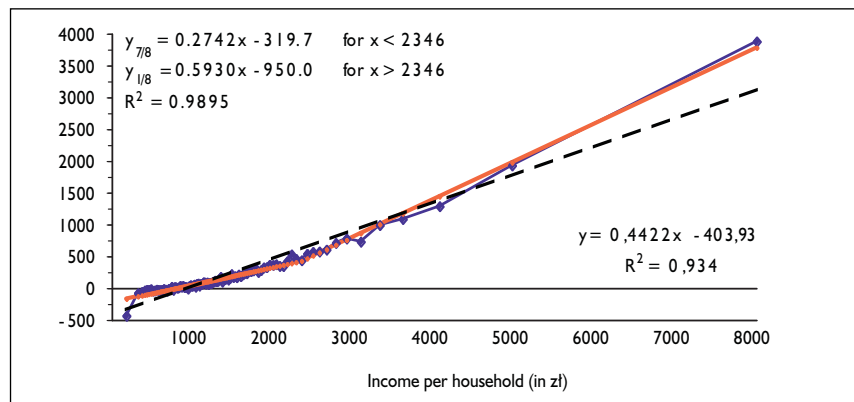
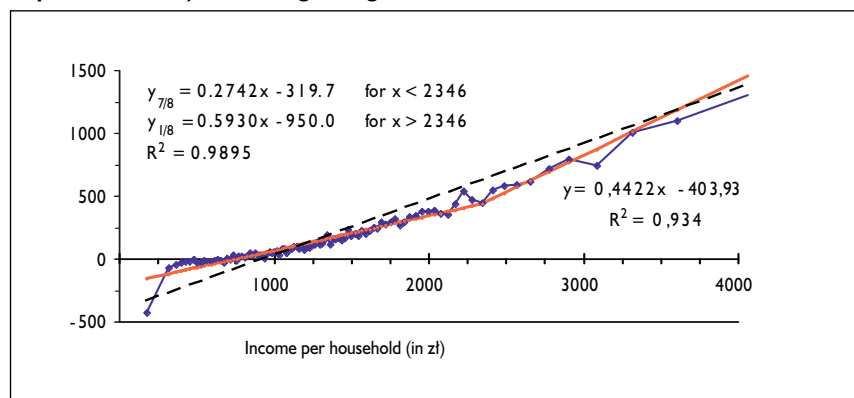


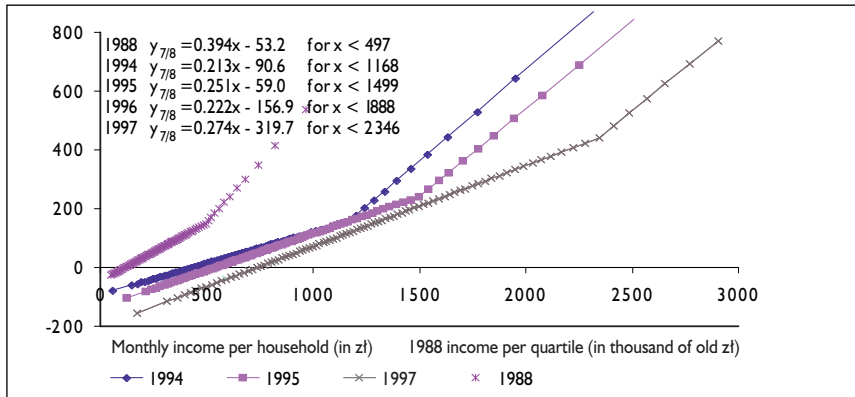
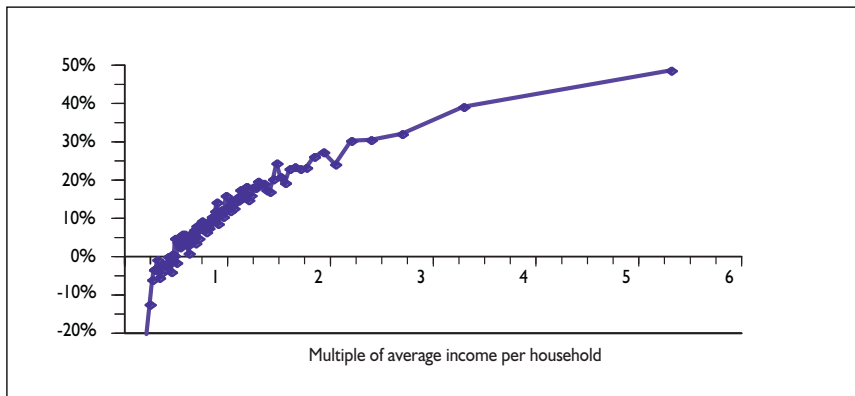
Figure 6b. Linear trend and the "kinked" saving function in 1997 (savings out of household disposable income) – an enlarged fragment



producer goods. Those high savings of farmers were caused by the difficulties to invest in agricultural production.

The distribution of household savings is very uneven. In years 1994–1997 about one fourth of households with incomes below half of the average income reported negative savings (Fig.8).

In years 1994–1997 the median saving rate rose from 6.25% to 10.1%, and the mean saving rate for households rose from 8.0% to 12.7%. The difference between median and the mean is the next sign of uneven distribution of savings. This discrepancy did not

Figure 7. Household saving functions out of disposable income; years 1988 and 1994–1997**Figure 8. Median saving rates of households in 1997**

change during the whole period under investigation and it was about one fourth. This means that the inequalities in saving distribution did not change. Because the saving rate depends strongly on income it may also mean that the income inequalities did not change in years 1994–1997. The income inequalities increased in the earlier period, i.e. in years 1992–1995 [Górecki, Wiśniewski, 1997].

The average saving rates start rising considerably above the level of 1.5 of the average income (in 1997 the average monthly household income was 1500 zł). A sharp increase

Table 3. Results of linear regression. Household savings (in thousand zł)

Multiple R	0.36408				
R Square	0.13256				
Adjusted R Square	0.13179				
Standard Error	1.09337				
Variables	B	SE B	Beta	T	Sig T
Four and more person families	-0.05763	0.008213	-0.05344	-7.017	0
Women households	0.011855	0.014541	0.004771	0.815	0.4149
Income tax rate	-0.60996	0.120339	-0.03232	-5.069	0
Households of employees-farmers	0.014361	0.024945	0.003612	0.576	0.5648
Households of farmers	0.18939	0.033577	0.035756	5.64	0
Households of self-employed	-0.09397	0.029919	-0.01935	-3.141	0.0017
Households of retirees and pensioners	0.016157	0.023703	0.006529	0.682	0.4955
Households of unemployed	-0.0398	0.037731	-0.00601	-1.055	0.2916
Decile 1	-0.37559	0.024289	-0.09518	-15.463	0
Decile 2	-0.26498	0.022144	-0.06782	-11.966	0
Decile 9	0.410654	0.021675	0.105098	18.946	0
Decile 10	1.392571	0.022736	0.356349	61.25	0
Age 30-34	-0.012	0.02934	-0.00288	-0.409	0.6825
Age 35-39	-0.07865	0.027402	-0.02169	-2.87	0.0041
Age 40-44	-0.10618	0.026225	-0.03211	-4.049	0.0001
Age 45-49	-0.10573	0.026578	-0.03114	-3.978	0.0001
Age 50-54	-0.08097	0.029662	-0.01997	-2.73	0.0063
Age 55-59	-0.10561	0.033769	-0.02357	-3.127	0.0018
Age 60-64	-0.09541	0.036722	-0.02167	-2.598	0.0094
Age 65+	-0.07397	0.034777	-0.0239	-2.127	0.0334
Primary education	0.114747	0.02615	0.043469	4.388	0
Vocational education	0.119092	0.024338	0.047626	4.893	0
Secondary and post-secondary education	0.078974	0.023137	0.030861	3.413	0.0006
Villages and towns below 20 thousand inhabitants	0.032818	0.01543	0.013933	2.127	0.0334
Ownership of a computer	-0.10158	0.023182	-0.02477	-4.382	0
Ownership of a car	-0.104	0.013703	-0.04702	-7.59	0
Ownership of a house	-0.00931	0.01749	-0.00388	-0.532	0.5945
Ownership of a flat	0.001635	0.016776	5.83E-04	0.097	0.9224
(Constant)	0.33252	0.042915		7.748	0

of the saving rates takes place when income exceeds the level of two times the average income. Saving rates become then 3–5 times the average rate for all households (which was 10% in 1977). The increase of the saving rates in the upper income groups of households in Poland is higher than in the USA. The maximum saving rate of 40% in the USA was observed for incomes 10 times higher than average [Huggett, Ventura, 1998]. In Poland the rate of 40% was recorded for incomes 3.3 times higher than average.

Other, except the disposable income, determinants of the households' saving have been estimated by the linear regression using some groups of dummy variables for the household source of income, family size, sex of family head, decile income group, education, age, place of living, and the characteristics of possessing of a house, an apartment, a car and a computer. The dummy equal 1 for: households run by women; households of employees; a group of 3 to 8 deciles of households; education of the household head; age group of 18–29 years, household living in villages and small towns below 20 thousand of inhabitants; and possession of a house, flat, car and a computer. Table 3 presents the regression results of savings for a full set of households in 1997 (31,776 observations).

The statistical fit of the regression function is in typical range for the cross-sectional studies of household surveys (adjusted R^2 equals 0.13). The results of estimation show the negative correlation of the age above 30 with saving, as compared to the age below 30. This negative correlation is weaker for the age group 50–54 and above 65.

The income inequalities are strongly correlated with saving. Moving up the income groups raises savings, most strongly in the 10th decile.

The effective income tax rate is negatively correlated with household savings [4].

Variables explaining the household sources of incomes were not statistically significant for the mixed households (employees-farmers) and for the households of retirees, as their patterns are very similar to those of employee households. The analysis showed that changing activity from hired employment into self-employment lowers household savings [5]. This result can reflect either the underestimation of income (and savings) of self-employed households, or it may show the growing indebtedness of households that is related to financing own future firms.

The elasticity of saving in respect to education is against expectations. Positive correlation of savings with the primary and vocational education, relative to the higher education differs from tendencies for the developed countries. It also shows low importance of persons with higher education in the total population in Poland (about 10%).

[4] Only taxes paid during the year of the survey were taken into account. Income was not recalculated when taxes overpaid had been reimbursed.

[5] Similar results were obtained in household budget surveys conducted in Poland by the World Bank in 1993 on 16 thousands of households [Denizer, 1998].

The regression analysis shows positive elasticity of savings on living in villages and small towns. However, the statistical differences in the saving rates between the country and big towns are very small.

Sex of the family head proved to be statistically insignificant for the saving behaviour.

Savings are negatively correlated with the number of persons in a family of four and more. However, average saving rates rise when a family grows from 1 to 3 persons (Table 2). It means that an additional adult person in the family increases savings, while additional children rather lower household savings.

Factors describing ownership of a house and a flat proved not statistically significant for household savings. It may be caused by the fact that the ownership of houses is a common feature in villages and small towns, while in big towns the ownership of flats prevails. Thus, the ownership of a house and a flat does not differentiate the households. The lack of wealth effect in case of houses and flats in Poland shows that these assets are not yet treated as a possible source of income.

It is also important how this ownership has been acquired. In villages most of houses were built without credit, and inheritance of houses goes together with the ownership of a farm. The ownership of apartments in towns came into being to a large extent by taking over the flats built and financed earlier from public funds. Flats were bought out at prices generally lower than the market value. It was very often a single act, thus, it did not require earlier saving for this purpose (except for pre-paying for flats in the housing communities, to the extent of 10 or 20% of a house value). Also, lack of mortgage registers for most of flats breaks the relation between ownership of a house and saving.

Negative elasticity of saving in respect to possessing durable goods (a car and a computer) is a sort of approximation of a negative wealth effect. The negative wealth effect means that ownership of a house, and household's saturation with durables lower propensity (and necessity) to save. The wealth effect can deepen with development of a market for consumption credit. On the other hand, development of mortgage credit market, which facilitates financing of a house with long-term credit, may have positive impact on saving. The mortgage instalments for housing investment force saving in equal amount. Moreover, investment in housing very often generates extra savings that are higher than the original mortgage credit.

5. Conclusions

Statistical analysis of household savings in Poland in years 1994–1997, based on microeconomic data, revealed the following determinants of saving:

– Household saving is very strongly connected with the household's disposable income. This is in accord with Keynesian theory of consumption and is similar to trends observed in the less developed countries.

– The saving function from disposable income is not strictly linear, but parabolic. Because a visible rise in saving takes place when income surpasses 1.5 times the average income, the saving function has been estimated as a "kinked" function.

– The marginal saving rates of the upper income groups of households (1/8 of all) are 2.5 times higher than the marginal saving rates of bottom income groups of households (7/8 of all households).

– The distribution of savings is more uneven than distribution of income. The average saving rates double faster than income (Fig. 8).

– According to the household budget surveys in years 1994–1997 the household saving rates rose by half. Yet, the inequalities in saving distribution did not change during that period.

– The household savings in the in 1990s reflect actual budget constraint of the Polish economy and do not contain forced savings that characterised the previous system of the centrally planned economy. The household saving rates in Poland do not differ much from the average for the OECD countries [Liberda, Tokarski, 1999, Poterba, 1994].

– The saving profiles of households in Poland according to demographic features resemble only partially the profiles which should follow from the life-cycle theory. The high saving rates of young households (up to the age of 30–35) do not follow the model. However, the relatively high saving rates (close to the average saving rate) of persons above 65 years are in accord with trends observed in richer countries.

– Systemic transformation in Poland seems to favour young persons and those, who were 55–60 years old in the threshold years (1989–1990). Adjustment to the new saving rules under the new system was the poorest in the group of people who were then in the age of 35–40 (in the surveys' time they were 40–45 years old). The reason must have been the highest cost of upbringing children in this group. Moving of the now young households with high incomes to the middle of the life cycle should increase the saving ratios of the age group of 40–50.

– The analysis did not prove the expectation of higher saving rates of self-employed households. But, in this case the inaccuracy of data may affect the results strongly.

– The differences of households saving rates between the different sources of income are rather small. The average is determined to a large extent by the households of employees and mixed households (employees-farmers).

– Statistical analysis showed non-existence of a visible wealth effect regarding saving. Wealth effect does not exist as yet for ownership of houses and flats. But, with rising incomes, increasing housing investments, and with development of financial market, one

can expect the deepening of the negative wealth effect for saving (in case of not possessing a home it means an increase of saving).

– The results of analysis that are different from what was expected and which differ from trends for developed economies are: positive elasticity of saving in respect to primary and vocational education; positive correlation of saving with living in villages and very small towns (below 20 thousands of inhabitants); lack of visible decrease of saving rates in big families consisting of four and more persons.

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Part II. Costs and Benefits of the Pension System Reform in Poland – the Impact on Savings

I. The Model and Real Costs of PAYG and Fully Funded Systems

The necessity of pension system reform in Poland stems from demographic factors (i.e. ageing of population especially after 2010–2020) as well as from ineffectiveness of the current PAYG system. A shift from the current PAYG to a fully funded system entitles transition costs. These costs arise because of the necessity to cover the pensions of those who remain within the PAYG system. At the same time, payments into the system are reduced by a group of people who transfer their contributions to a new fully funded system. The transition period is relatively long and covers the interval in which the 30-year-olds (in 1999) will still benefit from the PAYG system for maximum of 38–46 years.

The high costs of the reform are also associated with a relatively high degree of generosity of the former pension system in Poland. The latter stems from the cumulating of privileges of given social groups, abuse of granting disability benefits and a lowering of the retirement age in order to solve unemployment problems (so called *early pensions*). Therefore, a relatively short working lifetime and, in turn, short average period of contributing, and common cases of cheating (e.g. problem of people 20 and 30 years of age entitled to social benefits) are the main causes of a severe strain on the pension system in Poland.

At the same time, the pension system was used as an income policy instrument without considering the possibility of balancing revenues and expenditures of the Social Insurance Fund (ZUS) and the Farmers Social Insurance Fund (KRUS). Thus, the indexation of social benefits in line with wages (full indexation until 1993, then lowered to 0.9 of wage growth) caused rapid growth of the average social benefits in comparison to wages.

The share of the average social benefit in the average wage exceeded 64% and the average pension reached 74% of the average wage. Since then, both figures slightly dropped to 60% and 70% in 1997 respectively [CSO, 1998a, 157]. The level of relative generosity is comparable to those prevailing in Sweden and Italy and is among the highest in the world [Golinowska, 1997, 16; Averting, 1994, 104]. The comparison does not, however, concern absolute values of benefits as they, like wages, vary across countries.

The life span, and in particular the retirement lifetime (i.e. period of economic passivity), is the last macroeconomic variable that determines the final level of costs of

the pension system reform. The *passivity ratio* (the ratio of retirement lifetime to working lifetime) is a base for calculation of income necessary to finance consumption during retirement and, thus, a base for calculation of savings (contributions) during the working lifetime. For many individuals the passivity period depends on the retirement age and the life-span but it could be shorter for individuals remaining employed after reaching the retirement age or it could be longer for those who, for various reasons, start receiving social benefits before reaching the retirement age. Overall these deviations cancel each other out and the actual number of pensioners should correspond to the number of people of the retirement age who participate in the pension system. The number of pensioners can be referred to the actual number of people of the retirement age as the ZUS PAYG system was generally addressed to all non-farmer people.

The ratio of population of the retirement age to economically active people is referred to as the *demographic dependency ratio*. In a macroeconomic scale, it should correspond to the *passivity ratio* – the ratio of the average retirement lifetime to average working lifetime. In Poland the two ratios differ significantly from each other, and this will be shown below.

People receiving social benefits other than pensions (e.g. disability and family benefits) increases the number of beneficiaries. This causes the number of people receiving social benefits and the number of people of the retirement age to differ from each other. The ratio of pension system beneficiaries to contribution payers is referred to as the *system dependency ratio*. Such a measure differs significantly from the demographic dependency ratio and the passivity ratio.

A model that compares costs of a PAYG system and of a fully funded system in Poland over the period 1998–2040 is presented below. The analysis is based on the model employed in the World Bank report on the ageing of world population [Averting, 1994, 297]. The base model is augmented in order to adjust to Polish characteristics. The demographic dependency and system dependency ratios are assumed equal in the World Bank model. They do differ in Poland and this implies a need for an analysis of two cost scenarios of the former PAYG system reform.

The assumptions of the cost model under the PAYG and fully funded systems are as follows:

1. In the PAYG model a pension equals a fixed part of wages and thus is indexed in line with wages growth.
2. The level of contribution (in relation to wage) depends on the target ratio of pension to wage and on the demographic dependency ratio

$$C_r = B \cdot D \quad (1)$$

$$D = D_d = D_s$$

where:

C_r – contribution as a percentage of wage

B – target pension to wage ratio (benefit rate)

D_d – demographic dependency ratio (ratio of people of the retirement age to economically active people)

D_s – system dependency ratio (ratio of system beneficiaries to contribution payers).

Under a fully funded system individuals have to save throughout working lifetime assets sufficient to finance the assumed stream of pension benefits throughout the expected passivity period. The payment C_k into the system is a part of wage W in the initial year. During the n -year period of work wages and social benefits grow at an annual rate of $l+g$ (approximately equal to the rate of GDP growth). The accumulated contributions increase annually at a $l+r$ rate, where r is the interest rate (rate of return on capital).

At the time of retiring, the individual's accumulated assets during the n -year working lifetime equals:

$$C_k W [(l+r)^n + (l+g)(l+r)^{n-1} + \dots + (l+g)^{n-1}(l+r)] \quad (2)$$

At the moment of retiring, the discounted present value of future pension payments indexed to wages at a benefit rate of B of wage, and calculated over the m -year retirement lifetime equals:

$$BW(l+g)^n [l + (l+g)/(l+r) + \dots + (l+g)^{m-1}/(l+r)^{m-1}] \quad (3)$$

where:

n – number of working years

m – number of years in retirement

m/n – passivity ratio.

It is assumed that g , r , n , m are constant over time.

In a fully funded system the expressions (2) and (3) are equal – the accumulated capital has to equal the present value of future pension benefits.

If we assume that in the long run the rate of wage growth (and rate of GDP growth) equals the interest rate (rate of return on capital), i.e. $r = g$, then (2) and (3) reduce to the following formula:

$$C_k W (l+r)^n \cdot n = BW(l+g)^n \cdot m \quad (4)$$

so

$$C_k = B(m/n) \quad (5)$$

Thus, the required contribution to the fully funded system depends on the passivity ratio and the target pension to wage ratio.

It also follows from (2) and (3) that if $r < g$, then $C_k > B(m/n)$. If the interest rate is lower than the rate of wage growth, a contribution to a fully funded system has to be higher in order to generate the assumed stream of benefits provided the passivity ratio remains unchanged. If $r > g$, then $C_k < B(m/n)$. If the interest rate is higher than the rate of wage growth, then cumulative contributions rise quicker than liabilities due to the assumed stream of pension benefits and, thus, the contribution can be lower as compared to the case where wage growth rate is equal to the interest rate. The contributions must be also rising if the passivity ratio (m/n) or pension-wage ratio (B) go up.

A comparison of the two PAYG and fully funded systems proceeds as follows:

- I If $D = D_d = D_s$,
 $R = g$ and $D = m/n$,
 then the two systems do not differ with respect to costs, and thus with respect to contributions.
- II If $D = D_d = D_s$,
 $r = g$ and $D < m/n$,
 then the PAYG system outpaces the fully funded one. This means that the population covered with insurance is relatively young (i.e. many young people contribute to one pension) hence, the contribution is lower than it would be under a fully funded system.
- III If $D > (m/n)$ and $r = g$,
 then the fully funded system performs better than the PAYG one. The population is relatively old (high D) and thus contributions under the PAYG system would have to be higher than those under a fully funded system are.
- IV Assuming *ceteris paribus* conditions:
 if $r > g$ a fully funded system is cheaper
 if $r < g$ a PAYG system is cheaper
- V If $D > (m/n)$ and $r > g$, then a fully funded system performs better than a PAYG system in absolute terms.
- VI If D_d does not equal D_s then the system has to adjust to the actual system dependence ratio (D_s). A situation where $D_s > D_d$ is more common. This is the Polish case. The relative costs of pension systems will depend on whether

$$D_s > m/n$$

$r > g$ is the case or vice versa.

The above model is applied to the Polish economy. The demographic dependency ratio is relatively low in Poland; i.e. Polish society is yet relatively young. In the mid-90s a ratio of people over 65 to people 20–64 years of age stood at 0.20 (i.e. 1:5). Taking account for the retirement age stipulated in the legal acts (60 for women and 65 for men) and relating the population over these limits to groups of age 19–59 (women) and 18–64 (men), the demographic dependency ratio amounted to 0.24 – approximately 1: 4 (i.e. 4 employees paying contributions for one pension). It is a very low ratio. If it were equal to the system dependency ratio, then the contribution to the ZUS could be some 15% according to the following formula:

$$C_r = B \cdot D$$

$$C_r = 0.60 \cdot 0.24 = 0.144 = 15\%$$

given a high ratio of average social benefits to average wage, which stood at 60% in 1997 ($B=0.6$).

However, the system dependency ratio is considerably higher. As the matter of fact, a number of people receiving social benefits is significantly higher than indicated by demography. The figure stood at 9.3 mln in 1997 versus 13.1 mln insured in the ZUS and 1.4 insured in the KRUS so

$$D_s = 9.3 \text{ mln} / 14.5 \text{ mln} = 0.64.$$

Hence, the system dependency ratio in Poland is over 2.5 times higher than the demographic dependency ratio. A 40-point gap between the ratios is a phenomenon on a world scale.

The discrepancy between ratios D_d and D_s stems from a disproportionally large number of people entitled to social benefits other than pensions as compared to pensioners. In 1997 there were 9.3 mln beneficiaries of which:

- 3.4 mln of pensioners receiving pensions due to employment,
- 2.7 mln people receiving disability benefits,
- 1.2 mln people eligible for family benefits,
- 2.0 mln individual farmers receiving social benefits [Statistical Yearbook 1998, 157].

The average social benefits of the above groups constitute the following proportion of average wages:

- average pension – 70%,

- average disability benefit – 50%,
- average family benefit – 60%,
- average benefit for farmers – 42% [Statistical Yearbook 1998, 150].

Thus, the pension system is very generous. Pensions and other social benefits do not drop below 50% of average wages, which is a target level adopted in the draft of the reform. The only exception is farmers' pensions (mainly due to bequeathing of land). In this case benefits constitute roughly 40% of wages. This level is employed in numerous reforms of pension systems around the world as a maximum level guaranteed by a state. The additional factor that imposes a burden on the farmers pension system is a very low level of farmers' contributions accounting merely for 5% of farmers pensions (R. St. 1998, 474, 158). This results from historical regulations applied to the group. Currently farmers' pensions do justice to this social group that was not treated equally under the former political system. However, the long-run strategy of farmers' pensions requires an increase in farmers' contributions.

According to present levels of the system dependency ratio (0.64) and the ratio of wage-pension substitution, the level of ZUS contribution should be 38%

$$C_r = 0.6 \cdot 0.64 = 0.384.$$

A difference between this level and the current level of contributions to the ZUS (45%) points to an inefficiency of the PAYG system as well as to the fact that contributions cover other social benefits in addition to pensions and disability benefits. Thus, there is the conclusion that the cost of the former PAYG system, as measured in terms of contributions level, is three times higher than the level of contributions according to demographic indicators (45% contribution is three times higher than the hypothetical 15% one). Although, due to some system-factors the cost would be only 2.5 times larger ($38:15=2.5$).

A comparison of the PAYG system and the fully funded one requires a computation of the passivity ratio. In the mid-90s in Poland the ratio m/n amounted to approximately 0.4. It is obtained through division of the average retirement period (15 years) and the average working lifetime (37 years), so $m/n=15/37=0.4$. The length of work and retirement periods is determined, on the one hand, by average lifetime (68 years for men and 76 years for women, on average 72 years) and, on the other, by the effective age of retiring (55 years for women and 59 for men, on average 57 years) [Golinowska, 1997, 18]. Hence, the average working lifetime is 37 years ($57-20=37$). The age of 20 years is taken as a base age at which people commence work, and not the age of 18 years as stipulated in the labour law, because the coefficient of youth employment in the group of 15–24 years of age is negligible (0.3 of economically active in this group) and it only rises

in the group over 25 years of age (0.75 of economically active) [CSO 1998a, 121]. Employing the age of 20 years in setting the working lifetime seems to be justified. Such age will be also consistent with the popularisation of higher education until the age of 19, and in this respect the age is more suitable for forecasting purposes. Moreover, this age is a bottom age limit of workforce employed in the models of employment growth in OECD countries.

The comparison of the PAYG system ($C_r = B \cdot D_s$) and the fully funded one ($C_k = B \cdot m/n$) suggests that even now the latter would be cheaper as

$$\begin{aligned}C_k &= B \cdot m/n < C_r = B \cdot D_s \\C_k &= 0.6 \cdot 0.4 = 0.24 < C_r = 0.6 \cdot 0.64 = 0.384.\end{aligned}$$

Apparently, the contribution under the fully funded system of 24% would be lower than the present ZUS contribution of 45%. This calculation also shows that the current demographic and system relations suggest that the contribution of 36%, which will be maintained after the reform in the first pillar (ZUS), should cover most social benefits expenses provided the more disciplined ZUS system (the theory says about contributions of 38.4%).

For the sake of profoundness of the analysis, it should be said that if the Polish pension system prevailing so far relayed more heavily on the demographic dependency ratio ($D_d=0.24$) than on the system dependency ratio (D_s), then the PAYG system with the contribution of 14.4% would be cheaper as

$$\begin{aligned}C_r &= B \cdot D_d < C_k = B \cdot m/n \\C_r &= 0.6 \cdot 0.24 = 0.144 < C_k = 0.6 \cdot 0.4 = 0.24.\end{aligned}$$

The weight of demographic factors in this calculation is very significant. It turns out that if the pension system took greater account for demography, then it would be much cheaper. This is quite important for the present demographic relations will not be changed until the year 2010. The demographic dependency ratio (D_d) is to reach 24% in 2010 (alike in 1995), and only in 2015 to increase to 29% and to 34% in 2020 [Security, 1997, 24]. Therefore, the necessity for reforms of pension system in Poland does not stem primarily from demographic reasons, although they are important in the long run. The reform of pension system is driven mainly by the very high system dependency ratio. In this case, the reform should in the first place lower the ratio through limiting pension privileges, eliminating loopholes and abuses of granting disability benefits as well as through increasing farmers' contributions or introducing contributions for some groups previously not covered (in particular for professional soldiers, policemen, firemen, etc. –

so called uniform pensions). Under the reform a gradual lowering of the ratio of wage-pension substitution (B) so as to reach ultimately 50% is envisaged. This will be hard to achieve due to social reasons and for it will bring a negligible saving in the system.

It is striking that there is no attempt to lengthen working lifetime what, in turn, relatively decreases a number of future pensioners. Maintaining the lower retirement age for women is incomprehensible given their longer life span and relatively better education attainment in comparison to men. In 1997 45% of women over 19 had secondary and higher education, whereas the figure for men was only 35% [CSO 1998b, 66, 102]. Thus, the shorter employment period for women is a waste of human capital. The present demographic relations secure 12 years of a relatively easy transformation to the fully funded system. The generation of the post-war population boom will be still working in this period. Thus, it is possible to improve the pension system parameters that are related to demography but can be altered by economic policy over the period. In particular the active working lifetime should be lengthened. This is possible if the pension system is not used to solve unemployment problems. The right to earlier pensions (by 5 years) as well as abuses of granting disability benefits will contribute directly to shortening of employment periods and in turn to an increase in the passivity ratio (m/n).

In my opinion, unemployment policies and the pension system should be separated. Unemployment is primarily influenced by economic growth. Sustaining fast growth until 2010 would facilitate employment of young people (children of the generation of the post-war population boom) as well as of the people of the boom themselves [Liberda, Tokarski, 1999]. This will be even more crucial after 2010 because labour supply will diminish relatively as a result of people of the 1990s population depression joining the labour force.

Any increase in working lifetime of one year lowers the passivity ratio and, in turn, costs of pension system (given the assumption that the life span is rising as well). For instance, a lengthening of effective working lifetime by 2–3 years, provided for extending of life span, decreases the passivity ratio by 4–5 points. To be more specific, the lengthening of working lifetime by 2 years and the life span by 1 year yields the m/n equation (in relation to the present figures) as follows

$$m/n = (73-59)/(59-20) = 14/39 = 0.36,$$

and by 3 and 2 years respectively

$$m/n = (74-60)/(60-20) = 14/40 = 0.35.$$

If such processes took place prior to 2020 (demographic forecast sets a 3-year increase in the life span over the period [CSO 1998b, 98]), then the passivity ratio (m/n) and the dependency ratio ($D_d=0.34$) would converge. It would mean that a ratio of retirement period to work period equals a ratio of pensioners to economically active people. Then a choice of pension system would be possible. However, in Poland such a situation will not occur until 2020 as the actual system dependence of the pension system (D_s) is higher than the demographic dependence (D_d). The system dependency ratio will be likely decreasing after the introduction of mixed system (PAYG and fully funded). Although it is doubtful that the ratio would nearly halve by 2020. However, even now the proportion of pensioners and family members of ex-employees receiving family benefits (4.6 mln in total) account only for 32% of the people contributing to the system. The problems arise in the case of disability benefits as well as farmers social benefits. Hence, it is more likely that the system dependency ratio will lower considerably only after 2020 and definitely after 2030, when the generation of the post-war population boom will quit the pension system. A more detailed forecast would require an in depth analysis of the flow of current pensioners age. Such a forecast would be still biased due to the assumption on life expectancy. Under the life-span forecast of 78–80 years in 2030–2040 [CSO 1997, 12] and the assumption of extending the working lifetime up to an age of 65 would cause the three ratios (demographic dependency ratio, system dependency ratio and passivity ratio) to equalise in this period. They would stabilise approximately at a level of 33%:

$$D_d = D_s = (m/n) = (80-65)/(65-20) = 15/45 = 1/3 = 33\%.$$

Then the contribution (= payment into the pension system) could be something between 16% and 33% of wages, under the assumption that pension is 50% or 100% of wages.

$$\text{Given } m/n = D_s = D_d = 0.33$$

$$C_r = C_k = C$$

$$\text{for: } B_1 = 0.5 \quad C = 0.5 \cdot 0.33 = 16.5\%$$

$$\text{for: } B_2 = 1.0 \quad C = 1.0 \cdot 0.33 = 33\%.$$

The exact time of equalisation of the ratios (2030 or 2040) will hinge on how long the generation of the post-war population boom will be willing to work and for how long it will stay alive.

2. Pension Savings According to the Life Cycle Theory

Relating of pensions to wages is a kind of technical measure. As a matter of fact, the pension (i.e. income and consumption during retirement) should be related to the lifetime income, which is a smoothed income of entire life. According to the life cycle theory, one can assume that consumption during retirement should be as high as the lifetime average consumption. However, this means it cannot be equal to the income over the working lifetime because the income must be partly saved for pension. The savings rate for this purpose results from the expected retirement lifetime, but related to entire active lifetime and not only to working lifetime. In the case of the last example it would amount to:

$$s = (80 - 65) / (80 - 20) = 15 / 60 = 1/4 = 25\% \quad (6)$$

Therefore, in order to obtain pension at a level of consumption over the working lifetime one would have to contribute to the pension system 1/4 of wage income. This would mean that consumption would constitute 75% of wages and would be the same over the retirement period.

Thus, if $s = C = 0.25$ $B = 0.75$,
then $m/n = 1/3$ (i.e. the retirement lifetime would still be 1/3 of the working lifetime),

$$s = C = B \cdot m/n$$

$$\text{so } s = C = 0.25 = 0.75 \cdot 0.33.$$

This means that consumption in retirement equal to consumption in the working lifetime would constitute 75% of wage income given 45 working years and 15 retirement years.

On the verge of pension system reform in Poland, the working lifetime is lower than in the case under consideration, in which ultimate proportions for the ratios after the reform are set. Let us insert actual data on the Polish economy to equation (6). According to the life cycle theory, in order to secure consumption over retirement equal to consumption over the working lifetime we should save 29% of income given 37 years of work and 15 years of retirement on average

$$s = 15 / (37 + 15) = 15 / 52 = 0.29 = 29\% \quad (6a)$$

How much do we actually save for this purpose? In 1997 contributions to the ZUS and the KRUS stood at PLN 56.4 milliard. The sum of disposable household income

amounted to PLN 339.3 milliard, while voluntary savings were PLN 45.4 milliard [CSO 1998a, 474, 527]. The sum of disposable income and the contributions to the ZUS may be treated as household lifetime income according to the life cycle theory. It amounted to PLN 395.7 milliard. Households paid 14.2% of this amount to the ZUS for the future pensions and saved 11.5%. So they saved 26% of lifetime income and consumed 74% of it. According to equation (6a), households should save 29% of their lifetime income to have smooth consumption over the entire lifetime.

If total voluntary savings were devoted for pension insurance in the third pillar, then consumption during retirement, which can be achieved by spending 26% of lifetime income, would be 65% of current income – according to equation (7).

$$C = s = B \cdot m/n$$

$$B = s : (m/n) \quad B = 0.26 : 0.4 = 0.65.$$

The level of consumption, which results from saving only the current ZUS contributions, amounts merely to 35% of current total average income (i.e. not only wage income).

$$B_{ZUS} = 0.14 : 0.4 = 0.35.$$

Thus, in order to secure consumption during retirement at least at a level of 65% of present income one must devote total voluntary savings to the additional pension insurance. If we want to afford consumption during retirement at the level as during working lifetime (i.e. 71% of lifetime income), then 29% of income should be saved throughout the entire working lifetime. This means that if the obligatory contribution of the pension system in the first and second pillars is not changed, then voluntary savings must increase by 3 percentage points up to about 15% of life income. A 15% level of lifetime income savings implies a savings rate of disposable income of 17% (i.e. lifetime income deducted by the ZUS contributions). As now households save over 13% of disposable income [CSO 1998a, 527] their savings should rise by 4 points of disposable income. Such an increase and the devoting of all voluntary savings to future pension (i.e. total of 17% of disposable income) would be hard to manage for an average citizen and thus this seems impossible. An alternative solution is to limit consumption or/and lower own passivity ratio through lengthening the working life relatively to the entire lifetime and retirement life. The latter parameter depends to a large extent on individual's decision.

In the equation $s = C = B \cdot m/n$ all parameters can be influenced by an individual, although the parameter m/n has the biggest impact. Its lowering via lengthening of working lifetime facilitates income growth and, in turn, also higher voluntary savings for

pension purposes. Hence, it is not necessary to lower the standard of living during retirement and even the standard may increase if saved pension contributions bring high returns.

It is also important to study the parameters of own pension savings equation and bear in mind that the state pension system (the first pillar) does not take responsibility for the individual's overall consumption level during retirement. In fact, now it guarantees pensions at a level of 35% of household income. Changes in the awareness of society will be probably the weakest element of the success of the pension system reform. Thus, from the viewpoint of economic policy it is more important to make people aware of the necessity to save for retirement and encourage longer working lifetime and not to indicate threats stemming from the sustaining of the former system.

The awareness that the obligatory pension system guarantees future benefits at a level of roughly 1/3 of current total household income are very limited. The relating of pensions to wages, being a technical solution for a politician-economist, is not conducive to development of such awareness. The idea what we want to have when retired (i.e. amount and sources of pension benefits) is central to the reformed system. Basing on these needs one should decide on the length of working lifetime, amount of pension contributions as well as whether to save on ones own. The decisions will differ depending on the individual's age. Demography is important indeed. Freedom of choice of parameters in the saving equation is limited for people over 30 and in particular those over 40. The period over which an individual can save for pension is shorter and voluntary savings are reduced by obligatory contributions to the pension system. In fact, choice concerns mainly working lifetime that is a rational behaviour in the longer term. This will be hard to achieve as even in more developed economies a significant part of households do not make rational decisions with regard to pensions. For instance, in the USA a large part of households do not have individual savings for retirement at all and the median value of financial savings of households with heads 65 to 69 was USD 14,000 in 1991. The savings would cover at most one year of average consumption during retirement [Poterba, 1994, 181]. There are no reliable data on financial resources by household groups in Poland.

3. The Impact of the Pension System Reform on the Savings Rate

The transition from the PAYG system to the fully funded pension system can bring about positive effects such as increased rates of private savings and of total savings in the

economy and improved welfare. Several factors will be crucial in determining whether these positive tendencies will actually occur. Macroeconomic factors (e.g. interest rates, income and wages growth, government indebtedness) are important as well as the development of the capital market and the way in which the transition from one system to another will be financed (by borrowing or higher taxes). Not less substantial will be the behavioural factors, in particular the awareness of the circumstances and risks associated with the intertemporal choice and the willingness to risk. Hence, the microeconomic choices made by individuals are based on macroeconomic fundamentals, but the perception of risk associated with own choices is subjective in the end.

Among the macroeconomic variables the interest rate is of particular importance for the potentially advantageous outcomes of the pension system reform. The interest rate or more generally the rate of return on invested capital in relation to growth of wages determines whether the reform is actually beneficial and can influence the decision on its implementation. The higher rate of return from saved income in relation to wages growth, the relatively cheaper a fully funded pension system is. This is a straightforward consequence of the fact that in the situation described above invested contributions bring higher returns than benefits growth in a PAYG system. Thus, under a fully funded system current contributions could be lower or future benefits higher. Historically, during the last one hundred years interest rate on the invested capital outpaced wages growth [Maddison, 1995]. In dynamically effective economies real interest rates are higher than the growth rate. Currently the Polish economy is in the dynamically effective state and thus it has not yet reached the steady state point that can be derived from the so-called golden rule of accumulation. In the steady state marginal revenue from capital equals the rate of growth yielding a maximum share of consumption in income. In the dynamically effective state both the capital per employee and the share of savings in income can be changed without affecting consumption of present and future generations. If the PAYG system is employed in such an economy, the difference between interest rate and the GDP growth rate equals the real cost of contributions to the system. This is actually a dead-weight loss that results from no accumulating of contributions to a fully funded system.

A PAYG pension system lowers the effectiveness of economy as it distorts the labour market as well as may lead to a decrease in savings. The need to pay high insurance contributions diminishes wages and employment in the official sector with the business activity being transferred to the informal sector in order to avoid taxes. The rationale for such a behaviour comes from the fact that insurance contributions are proportional to wages and the return on contributions (benefit payments) is lower than the market interest rate on capital and also that there is a variation in pension benefits received by

individual pensioners (i.e. they receive benefits different from the average for a given cohort) [Arrau, Schmidt-Hebbel, 1993, 6]. Unless there is an intergenerational distribution of income favourable to seniors, an individual expects real benefits in the amount at least equal in the value of own contributions indexed by the wages growth rate. The difference between the interest rate on capital that would be earned if the insurance contribution were invested and the wages growth rate constitutes a pure tax. In the USA during the last 35 years this gap amounted to 6.7% per annum. In 1960–1995 the non-financial capital generated on average 9.3% of real income before tax while real wages grew at a average rate of 2.6% [Feldstein, 1996, 3]. This means that the cost of acquiring a pension in the state run system was in the USA many times higher than in the fully funded system. To put it differently, the PAYG system was characterised by the large dead-weight loss. Wiśniewski estimated the dead-weight loss of the Polish PAYG system at 3/4 of the contributions to the ZUS for men with average income and nearly 1/2 of the contributions to the ZUS for women. Pensions generated in a funded system would be cheaper by that amount [Wiśniewski, 1997, 29].

A PAYG system constitutes a negative incentive for the households' savings rate if the present value of future retirement benefits (social security assets) is a rising share of individual's total lifetime wealth. A private savings rate (s) is a function of income growth rate [equal to wealth growth ($p = \Delta A/A$)] and a ratio of wealth to income ($a = A/y$) [Modigliani, Sterling, 1983]. The relation can be written as:

$$S = \Delta A$$

$$s = S/Y = p \cdot A/Y = p \cdot a$$

Where:

Y – disposable income of the private sector

A – private wealth

S – private savings

If the individual's social security wealth (present value of future pension) covers the growing portion of total consumption during retirement, the rate of savings covering the remaining part of consumption during retirement decreases over time. Consequently, social security wealth crowds out private savings. Individuals decide to save less from their total lifetime earnings or to shorten the working lifetime thus reducing the total lifetime earnings and private wealth (wealth replacement effect). Feldstein notes that an increase in mandatory social security contributions also causes the effect of crowding out of private savings by social security wealth. The rise in mandatory contributions to a PAYG system lowers disposable income and thus also private savings [Feldstein, 1994].

The negative effect on savings of a PAYG pension system can be to some extent offset by expanding the retirement period that increases savings. Individuals rationally expecting longer period of economic passivity decide to save more in order to cover the part of increased consumption in that period that is not financed by the pension system. Modigliani and Sterling (1983) studied both effects of pension systems on private savings (saving reducing replacement effect and saving augmenting retirement effect). Their study covered 21 OECD countries in 1960–1970 and they estimated a relatively low coefficient of crowding out of private savings by the social security wealth and rather high coefficient for (indirect) effect of retirement age on the savings rate. Ultimately both effects nearly cancel each other out in a majority of countries. This means that the savings rate was kept at a certain level by shortening the working lifetime and extending a retirement period. The analysis also leads to a conclusion that a further increase in social security wealth can lower the private savings rate.

One of the highest ratios of crowding out of private saving by the social security wealth (mandatory social security system) for the USA was estimated at 0.5–0.6 by Feldstein (1996, 8). A number of other empirical studies for the USA and other OECD countries (review in OECD, 1998a) using both times series and cross-section data usually found lower crowding out ratios. The results suggest that the present value of future pension payments reduces private savings by 10% to 30%. The marginal effect of increase in the social security wealth on reducing savings is lower and amounts to around 5% [OECD, 1998a, 35]. The wealth accumulated in private pension funds has stronger negative influence on savings – around 50% (i.e. 100 units of present value of future pension payments from the private pension system reduce private savings by 50%) [OECD, 1998a, 11].

Cross-section data reveal differences in crowding out effects in various social groups. Generally, the wealthier and better-educated groups tend to react stronger in their intertemporal choices to changes in social security wealth than economically weaker groups. This phenomenon can possibly be explained by the fact that poorer individuals have very low savings or no savings at all and thus do not exhibit significant reactions in their intertemporal choices to increase in the present value of future pension payments. Some empirical studies found that private savings contract further when a state pension system is more mature and there is deeper awareness concerning future pension benefits. Barro and McDonald (1979) made the point that a crowding out ratio is found to be different in cross-section and time series analyses: countries with higher social security wealth exhibit higher savings, while the increase in this variable over time led to lower private savings.

Empirical studies also show that tax incentives, aiming at increasing household savings in pension funds effect in savings growing by 20–25% of the whole contribution [OECD, 1998a, 40]. Still, net effect on the national savings is much smaller and can even be

negative due to high costs of tax relieves. In countries where savings in additional pension funds increased significantly (e.g. 401(k) programme in the U.S.) other factors turned out to be more important than tax relieves, namely easy access to a pension system, knowledge about the characteristics of a system, increasing awareness of a need to save for the retirement period.

The studies mentioned above allow for drawing a conclusion that the scale of crowding out of savings by a stock wealth of future pension payments can increase with ageing of populations (as elderly people save less), decrease in a number of children in families and with development and liberalisation of credit markets (improved possibilities for incurring credits, including mortgage credits and credits pledged by insurance policies).

The effects of the reform of the former PAYG system on private savings will depend on the scope to which the PAYG system is replaced or complimented by fully funded systems. All empirical studies find significant positive correlation between levels of income and wealth and crowding out of the private savings by wealth due to future pension payments. Consequently, forcing poorer households to save in mandatory fully funded systems increases private savings. The increase in total savings depends then on the reaction of government savings. If the latter falls total savings can change. Thus, the effects of a pension system reform are also determined by the way, in which the transition from one system to another is financed.

The scale of potential increase in non-compulsory savings is determined by households' ability to predict correctly the value of future pension payments (from both the obligatory and the funded systems), the way in which these predictions affect the decision on the moment of retiring and whether individuals intend to leave bequest. The last factor is most difficult to assess. Assuming that individuals making decisions on savings take into account future generations utility (according to the Ricardo-Barro equivalence rule) the transition from the PAYG to the fully funded system will result in increasing willingness to save by individuals. In such a situation, it becomes irrelevant whether higher taxes or an increase in public debt finances the transition. This is because, according to the Ricardo-Barro equivalence rule, an increase in contributions to a PAYG system or an increase in taxes is a transfer from currently working generation to older generations. To keep private savings constant there should be counteracting voluntary transfer in the opposite direction.

Financing the transition costs by expanding public debt is nothing else but the swap of implicate future indebtedness to explicate current indebtedness. Consequently, the current generation should save more (benefiting from higher government expenditure) in order to allow future generations pay back the debt. In other words currently working generations finance both pension systems. Savings of this generation, that include

contributions to both state and a funded system, grow but their welfare falls unless they receive heritage. It is difficult to estimate empirically the scale of intergenerational transfers (the Ricardo-Barro equivalence). Transfers are neither universal nor always voluntary. Therefore private savings do react to changes in government liabilities and the Ricardian equivalence does not hold fully. Consequently, a way of financing the transition to funded pensions can influence the growth of private savings and its magnitude [Engen and Gale, 1997, 112]. International experience suggests that if the pension reform is financed by government borrowing and the Ricardo-Barro equivalence holds the effects on savings growth is ambiguous – can be either negligible, negative or slightly positive [OECD, 1998b, 29].

In Poland the scope for increase in personal tax rates in order to finance the pension reform is limited. The effective tax rate paid by households (12–13%) is already relatively high. Moreover, households' expenditures are indirectly taxed at a rate equal to around half the income tax rate (6–7% of households' income) [Bolkowiak, 1998, 42–43]. Additional taxes would negatively affect private savings. The research in OECD countries indicates that income taxes do less harm to savings than consumption taxes [Tanzi, 1998, 10].

The analysis presented above shows that neither significant increase in taxes nor excessive borrowing can be used to finance the pension reform in Poland. More reasonable solution seems to be to look for other sources such as privatisation or inflow of foreign capital [Liberda, 1998, 32]. The success of the reform depends on the extent to which the transition generation will be willing to increase its personal savings.

An increase in private savings would bring more capital and improve productivity that would partly counteract the effects of population ageing in the second half of the next century. On the other hand, the drop in labour force in future will reduce demand for investment and capital. If savings were invested only in capital markets, the rate of return would also be lower. Higher international capital mobility shall increase expected returns on capital invested in the markets in rapidly growing economies [Bosworth and Burtless, 1997, 258].

4. Conclusions for Economic Policy

The pension system reform has become a necessity because the role played by the generation of the post-war population boom in financing the PAYG system is coming to

the end. The reform, however, does not prevent a rise in costs of pension systems if the effective retirement age and retirement lifetime are not changed.

Economic policy should stimulate an increase in savings for pension purposes, however not via tax incentives (although they are of some importance) but via encouraging extending working lifetime and discouraging early retirement. The Polish reality missed these objectives. As it could have been justified at the beginning of the transformation period, now it cannot be. The shape of the enacted pension system reform in Poland, which upholds the pension thresholds prevailing so far and a number of pension privileges for many social groups, does not create sufficient incentives for rapid growth of savings in Poland.

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