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Socio-Economic Policy in Poland: A Year of Major Changes in Benefits, Taxes, and Pensions

2016 was the first full calendar year of the new Polish government elected to power in October 2015. The year marked a number of major changes legislated in the area of socio-economic policy some of which have already been implemented and others that will take effect in 2017. In this policy brief, we analyse the distributional consequences of changes in the direct tax and benefit system, and discuss the long-term implications of these policies in combination with the policy to reduce the statutory retirement age.

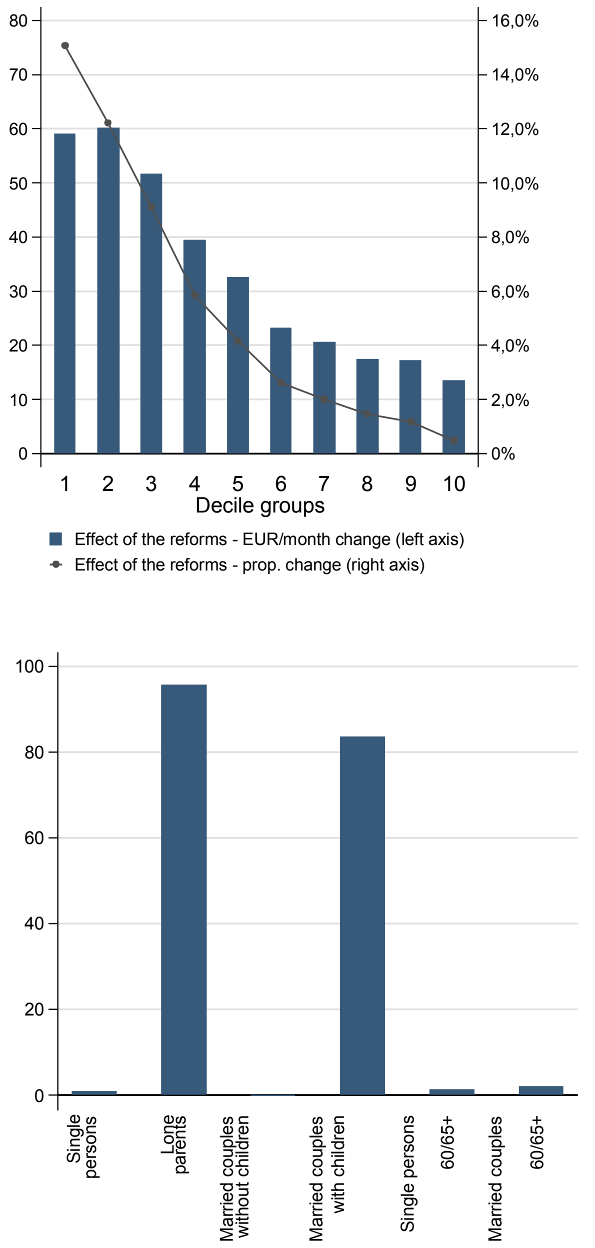
The Law and Justice party (Prawo i Sprawiedliwość, PiS) won an absolute majority of seats in both houses of the Polish Parliament in the parliamentary elections of October 2015. Earlier that year, Andrzej Duda of PiS was elected President of the Polish Republic. In both cases, the electoral victories came on the wave of pledges of significant financial support to families with children and to low-income households, especially pensioners. The new president pledged to cut back the pension age to the levels prior to the 2012 reform, which introduced a gradual increase from 60 and 65 to 67 for both women and men, and to nearly triple the income tax allowance. Following Duda's victory in May 2015, PiS reiterated these pledges in the parliamentary election campaign and added the promise to increase the total level of financial support for families with children by over 140% through a nearly universal benefit called "Family 500+" and to hike the minimum wage by over 8%.

Despite a rather tight budget situation, the government went ahead with the "Family 500+" and successfully rolled it out in April 2016 (Myck et al., 2016a). The new instrument directs support of 500 PLN per child per month (110 EUR) to all second and subsequent children in the family in the age group between 0 and 17. Benefits for the first child in the family in this age group are granted conditional on overcoming an income threshold of 800 PLN (180 EUR) per person per month. Since April 2016, over 2.7 million families have received the benefit and 60% of them received the means tested support (if they have more than one child this is paid out in combination with the universal benefit).

The second key electoral pledge – to increase the tax allowance from 700 to 1,850 EUR at an estimated cost of 4.8 billion EUR – has so far been postponed (CenEA, 2015a). Increases in the allowance became a major policy issue in October 2015 when the Constitutional Tribunal ruled that maintaining its level below minimum subsistence, as it was at the time, was unconstitutional. To satisfy the Tribunal's ruling, the allowance would have to increase to ca. 1,500 EUR at a cost of nearly 15 billion PLN (3.4 billion EUR, and about 0.8% of GDP, CenEA 2015b). Instead of a simple increase in the allowance, the government decided to implement a digressive tax allowance for 2017. This raised the value to the required minimum subsistence level for the lowest income tax payers, but since it is rapidly withdrawn as taxable income rises, the allowance will be unchanged to a large majority of taxpayers and will cost the public purse only 0.2 billion EUR (CenEA, 2016). This policy will be more than paid for by the fiscal drag given the decision to freeze all other parameters of the tax system, which will cost the taxpayers 0.5 billion EUR (Myck et al., 2016b).

The policies that directly affect household budgets will in total amount to about 5.5 billion EUR in 2017 (1.3% of GDP and 6.2% of the planned central budget expenditures) and will include also an increase in the minimum pension to benefit about 1.5 million pensioners. The cost of the "Family 500+" reform makes up the large majority of this value (5.4 billion EUR). Households from the lower income decile groups will benefit the most from this reform package, with their monthly disposable income increasing on average by 15.1% (ca. 60 EUR). High-income households from the top income decile will see their income grow on average by only 0.5% (see Figure 1). Overall, nearly all of the gains will go to families with children, with single parents gaining on average about 95 EUR and married couples with children about 84 EUR per month. Other types of families will, on average, see negligible changes in their household disposable incomes (see Figure 2). Thus, the implemented package clearly has a very progressive nature and redistributes significant resources to families with children.

Figure 1. Distributional consequences of changes in direct tax and benefit measures implemented between 2016-2017

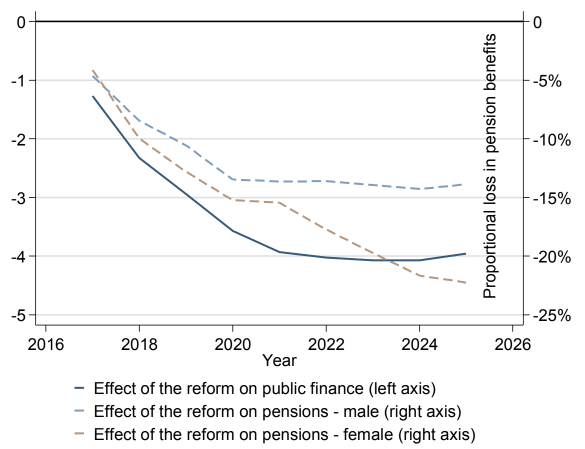


Source: calculations using CenEA's microsimulation model SIMPL based on PHBS 2014 data.

The pension age and public finances in the years to come

The most recent major reform, legislated at the end of 2016 and which will come into effect in October 2017, represents an implementation of yet another costly electoral pledge. This policy has overturned gradual increases in the statutory retirement age, initiated by the previous government in 2012. Despite the very rapid ageing of the Polish population, the new government decided to return to the pre-2012 retirement ages of 60 and 65 for women and men, respectively. This comes at a time when, according to EUROSTAT (Eurostat, 2014), the old-age dependency ratio in Poland, i.e. the proportion of the 65+ population to the working-age population, will grow from the current 24% to 27% in 2020 and to 40% in 2040. With the defined contribution pension system, the shorter working lives resulting from this change will be reflected in significantly reduced benefits (Figure 2). For example, pension benefits of men retiring in 2020 will on average be 13.5% lower than the pre-reform value. For women that retire in 2040, the pension benefits will on average fall by 15.2%, which corresponds to a 43% lower benefit than the pre-reform value, and with consequences of the reform becoming more severe over time. The reform will also be very costly to the government budget. In 2017, it is expected to cost 1.3 billion EUR and its full effect will kick in after 2021, when the cost of the reform will exceed 3.9 billion EUR per year (Figure 2).

Figure 2. Reducing the statutory retirement age and its implications on pension benefits and public finances



Source: Based on data from Council of Ministers (2016).

Conclusion

Since coming to power in October 2015, the PiS government has implemented a majority of its costly electoral pledges. Direct changes in taxes and benefits will cost 5.5 billion EUR in 2017 and benefit primarily those in the lower end of the income distribution and in particular families with children. The reduced statutory retirement age will add an extra 1.3 billion EUR in 2017 and as much as 3.9 billion EUR four years later. The very generous "Family 500+" programme has significantly reduced child poverty and may have important positive long-term effects in terms of health and education for today's beneficiaries. However, its fertility implications are still uncertain and the programme is expected to reduce the employment rate among mothers. While the government maintains that its financing is secured, it is becoming clear that maintaining the policy will not be possible without higher taxes.

The government came to power claiming that the implementation of this programme will be based on reducing tax fraud and that only a small fraction will be financed from tax increases. While it seemed likely at the time when these declarations were made, the expected major shift in the reduction of tax fraud has yet not materialised. The government have withdrawn from the pledge of reducing the VAT and from assisting those with mortgages denominated in Swiss Francs, while its income tax allowance reform was nearly thirty times less expensive compared to that announced in its electoral programme.

With a very tight budget for 2017 based on relatively optimistic assumptions, the key factors determining further realisations of the generous programme will be the rate of economic growth and related dynamics on the labour market. Developments of the labour market will also be essential for the longer-term economic success of the implemented reform package. This relates both to the future level of participation of women and to the success of extend working lives of people who will soon reach the new reduced retirement age.

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Michal Myck is Director of the Centre for Economic Analysis, CenEA, in Szczecin. He previously worked at the Institute for Fiscal Studies (1999-2004) and at the DIW-Berlin (2005-2010) where he is currently a Research Fellow. Since 2005, he has been the Polish Country Team Leader for the Survey of Health, Ageing and Retirement in Europe (SHARE), cooperating with the University of Warsaw and the Munich Institute for the Economics of Aging (MEA).

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