



EUROPEAN SOCIAL POLICY NETWORK (ESPN)

# Financing social protection

## Poland

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## Summary

Social protection expenditure in Poland, relative to GDP, was significantly below the EU average in 2016 (20.3% vs 28.2%). Social protection spending in Poland in the period 2005-2016 remained at around 20% of GDP, which implies that it kept pace with economic growth. In real terms, both social protection spending and the Polish economy grew much faster than in the EU.

The financing of social protection in Poland relies to a large extent on social contributions, which finance more than two thirds of social benefits and transfers. This, together with the high degree of decommodification, places Poland among the countries that can be characterised as following a 'conservative-corporatist' model of welfare state regime, according to the Esping-Andersen typology, but with a gradual shift towards a liberal regime after reforms introduced in the past.

Most expenditure on social protection in Poland in 2016 went towards old-age spending (46.4%) and healthcare (30.5%). These shares remained relatively stable over the 2005-2016 period. At the same time, there were significant changes in other elements of social protection spending. In particular, the share of family/childcare benefits increased to 12.8% of total spending in 2016, following the expansion of family policy. Between 2005 and 2016 the share of social protection expenditure on disability declined, in line with the reduced number of disability pensioners – a trend observed since the late 1990s. Further, due to a low and declining unemployment rate, the share of unemployment spending also fell.

There were significant shifts in the structure of financing within individual areas after 2008. Following changes in the composition of the old-age contribution, the share of contribution revenue in old-age spending increased significantly (from 50.6% in 2010 to 74.4% in 2017). At the same time, the expansion of maternity benefits, including lengthening the period of maternity leave, reduced the share of contribution revenue for short-term sickness and maternity benefits from more than 100% in 2007 to 62.5% in 2017. Changes in the disability contribution rate also led to a decline, and then increase, in the share of contributions in financing disability and survivor pensions.

The expansion of family policy financed from taxes maintained the share of general government tax revenue in overall social protection spending. Despite the expansion of non-means-tested benefits, with the 'Family 500+' benefit for second and further children, the share of spending in Poland on means-tested transfers targeted at low-income households remained significantly below the EU average (4.7% vs 12.1%) in 2016.

Social protection expenditure in Poland is heavily age-oriented. The bulk of expenditure is directed towards the older generation (including old-age pensions and healthcare). The development of family policy after 2008 did not change this dominance (however, it should be noted that education is not covered in this assessment).

Given the expected further ageing of the population, there are significant challenges related to securing the stable financing and delivery of social protection in Poland. Given the heavy reliance of financing on social contributions, the most important challenge in Poland is to maintain the growth of aggregate labour income – through prolonging working lives, improving productivity by investment in skill development, and supporting increased labour market demand for skilled workers. Further policy debate on diversifying sources of financing social protection is also needed, in the light of the changing nature of work (highlighted in the 2019 World Development Report). Another potential topic for discussion is an increase in the role of tax income (such as VAT based on a broad tax base) in financing social protection.

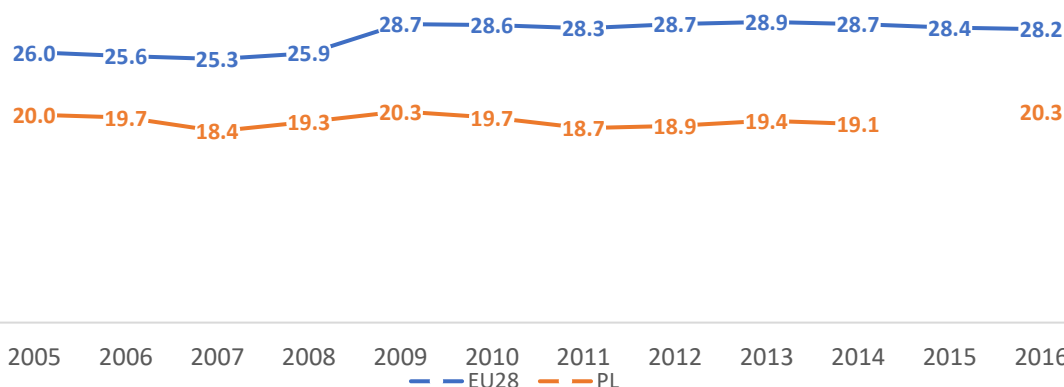
# 1 Current levels and past changes in financing social protection

## 1.1 Social protection in Poland: overall trends

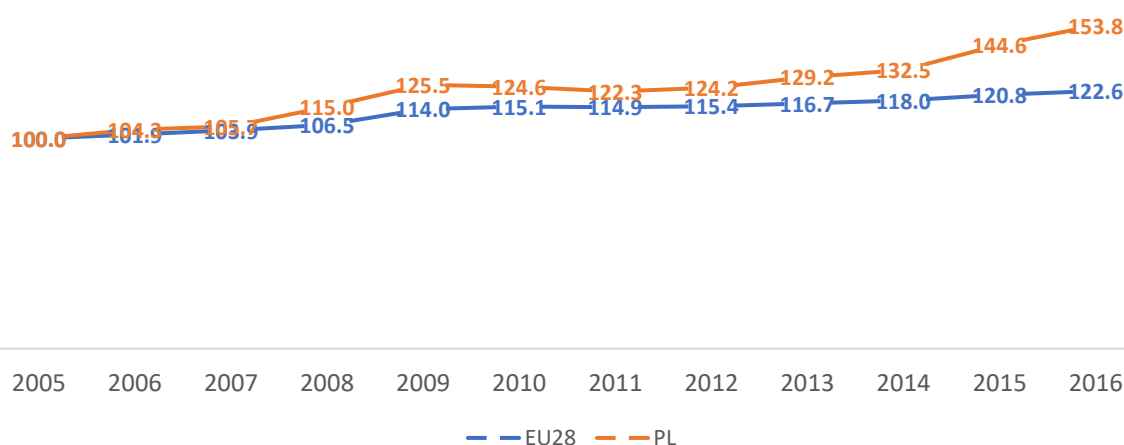
In 2016 social protection expenditure in Poland amounted to 20.3% of GDP, which was below the EU-28 average (28.2%). Between 2005 and 2007 the share of social protection expenditure in GDP declined from 20.0% to 18.4%; this resulted from a combination of favourable labour market conditions and declining social protection expenditure, particularly related to pensions (due to lower indexation of pension benefits). After 2008, social protection expenditure increased back to around 20% of GDP and then remained around 19–20% of GDP. Increased social protection expenditure in 2008 and 2009 was mainly related to higher pension expenditure. The rise of social protection expenditure in 2009 in Poland was much smaller than in the rest of the EU, as economic growth in Poland remained positive in the crisis period, whereas the rest of EU countries experienced a recession that led to increased social protection expenditure relative to GDP. As a result the difference in social protection spending relative to GDP between Poland and the EU-28 average widened and stabilised at around 8-9 p.p. (Figure 1a)

**Figure 1. Social protection expenditure in Poland and the EU-28, 2005-2016**

**a. as % of GDP**



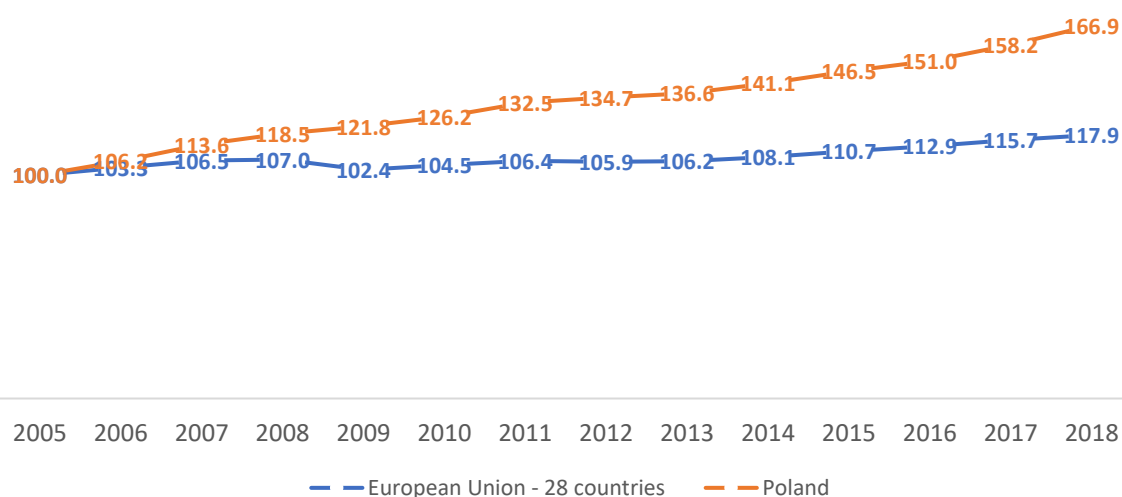
**b. in real terms (at constant 2005 prices)**



Source: Spasova and Ward (2019), Annex ESSPROS (European System of integrated Social PROtection Statistics) tables.

Between 2005 and 2016 overall social protection expenditure in Poland increased by 53.8% in real terms – much higher than the EU average of 22.6%, as shown in Figure 1b. This indicates that the social protection system in Poland expanded in line with economic growth, and that the widening gap between Poland and the EU in terms of expenditure relative to GDP was mainly caused by faster economic growth in Poland (Figure 2).

**Figure 2. Gross domestic product at market prices in Poland and EU-28, 2005-2018 (index 2005=100)**



Source: Eurostat database [nama\_10\_gdp].

Social insurance benefits in Poland such as pensions or sickness benefit are subject to health insurance and personal income tax. As a result, social protection expenditure was lower than gross expenditure by 2.5 p.p. of GDP in 2015, compared with 2.2 p.p. in the EU (Table 1). According to ESSPROS database, the effective tax rate on social protection expenditure in 2015 was 12.9%, which was higher than EU average (5.7%).

**Table 1. Gross and net social expenditure in Poland and EU-28, 2007-2015**

	% of GDP						% -point difference		
	Gross expenditure			Net expenditure			Net minus gross		
	2007	2010	2015	2007	2010	2015	2007	2010	2015
EU-28	25.2	28.6	28.3	23.5	26.5	26.1	-1.7	-2.1	-2.2
Poland	18.4	19.7	19.1	:	17.3	16.7	:	-2.5	-2.5

No data for net expenditure before 2010 for Poland. For Poland, figures for 2015 relate to 2014. The EU totals have been estimated on a consistent basis by taking the nearest year for which data are available where data are missing for any country.

Source: Spasova and Ward (2019), Annex ESSPROS tables.

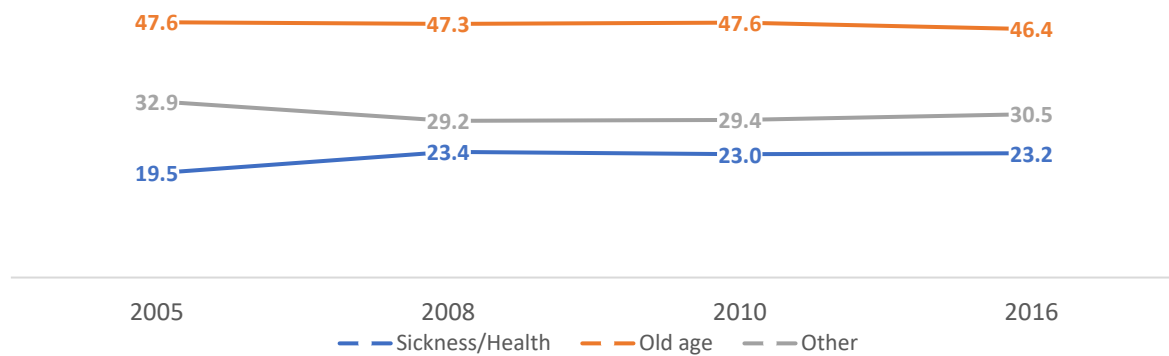
## 1.2 Social protection expenditure by function

The bulk of total social protection expenditure in 2016 (46.4%) financed old-age pensions, which was above the EU average (40.6%). The share of health spending was lower than in the EU (23.2% compared with 29.5%), while other social protection expenditure accounted for 30.5% – close to the EU average (30.5%). As shown in Figure 3, the shares for Poland were relatively stable during 2005-2016. Old-age pension expenditure declined slightly between 2005 and 2008, which was mainly linked to changes in pension indexation.



At the same time, the share of health and sickness benefits in total social protection expenditure increased. This was mainly linked to higher contribution revenue for healthcare, resulting from the overall growth of wages and employment in the economy as well as an increase in the wage base for healthcare contributions from 2007. The latter was caused, in turn, by the decline of social insurance contributions for disability and survivor pension insurance from 2007<sup>1</sup>.

**Figure 3. Breakdown of gross expenditure on social protection in Poland by function, 2005-2016 (% total expenditure)**



Source: Spasova and Ward (2019), Annex ESSPROS tables.

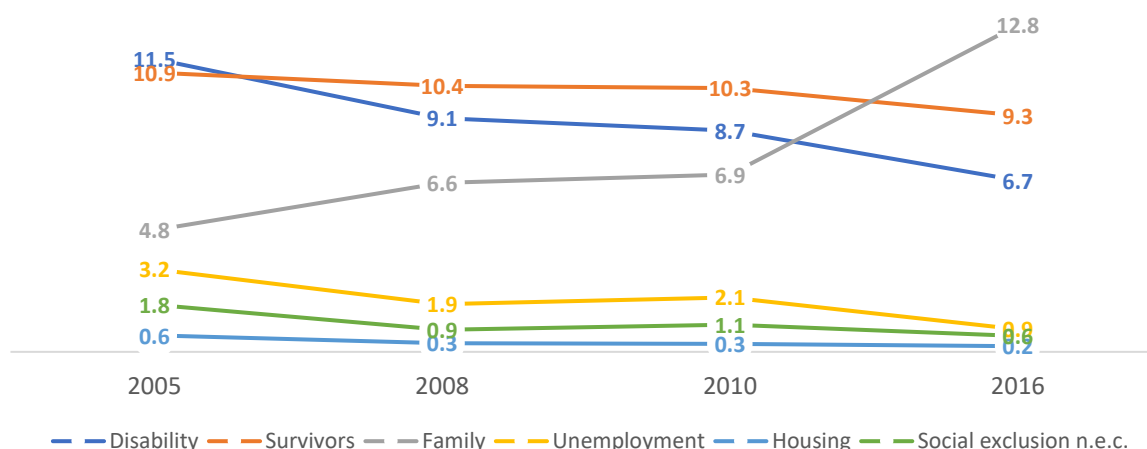
Although the share of 'other' expenditure in total social protection expenditure remained relatively stable, a breakdown of this category indicates significant shifts between 2005 and 2016, with a notable increase in the percentage of total expenditure in 2008 and 2016 spent on family benefits (Figure 4). This was a result of the expansion of family policy, most notably the extension of maternity benefits, increased childcare financing from 2008 and the introduction of the new 'Family 500+' benefit in April 2016 (discussed further in Section 1.2.3).

The decline in disability expenditure between 2005 and 2015 followed the trend that had started in late 1990s, after a reform of the disability assessment system that led to a reduction in the number of disability beneficiaries.

The reduction in unemployment expenditure was linked to the sharp drop in the unemployment rate observed in Poland from 2004.

<sup>1</sup> Healthcare contributions in Poland are calculated as a percentage of gross wages, reduced by social insurance contributions paid by employees.

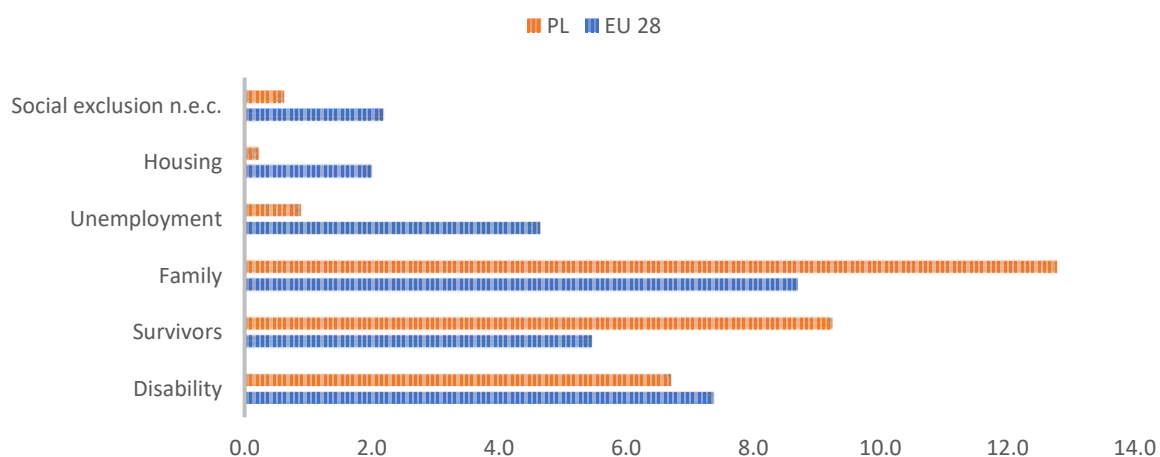
**Figure 4. Breakdown of gross expenditure in Poland by function in 'other' category, 2005-2016 (% total expenditure)**



Source: Spasova and Ward (2019), Annex ESSPROS tables.

As a result of these changes, as well as previous trends, the mix of social protection expenditure in the 'other' category differed from the EU average in 2016 (Figure 5): that is, the share of survivors and family benefits expenditure was higher, while the share of targeted benefits related to social exclusion, housing and unemployment was smaller.

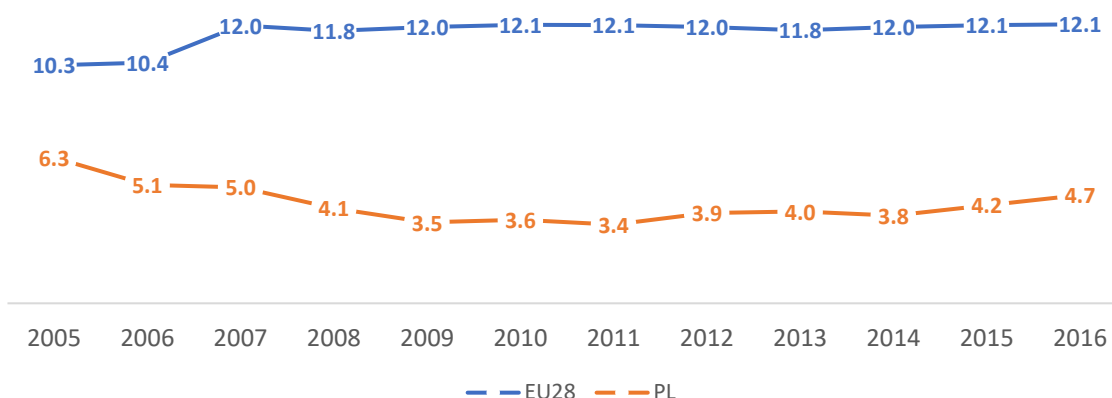
**Figure 5. Breakdown of gross expenditure in Poland and EU-28 by function in 'other' category, in 2016 (% total expenditure): Poland vs EU-28**



Source: Spasova and Ward (2019), Annex ESSPROS tables.

The evolution in social protection spending by function is also reflected in the evolution of the share of means-tested benefits (Figure 6). The falling share of means-tested benefits (i.e. social assistance and family benefits) between 2005 and 2011 was related to the declining number of recipients of these benefits, as most of the income thresholds used to assess eligibility did not change, despite the growing incomes of households. The rise in the share of means-tested benefits after 2014 was due to a revision of income thresholds and the introduction of the 'Family 500+' benefit for the first child, which is means-tested. Despite these changes, the share of expenditure on this type of benefit in total social protection expenditure remained below 5% between 2007 and 2016, which was much lower than the EU average.

**Figure 6. Share of means-tested benefits in total social protection expenditure, 2005-2016: Poland vs EU-28, %**



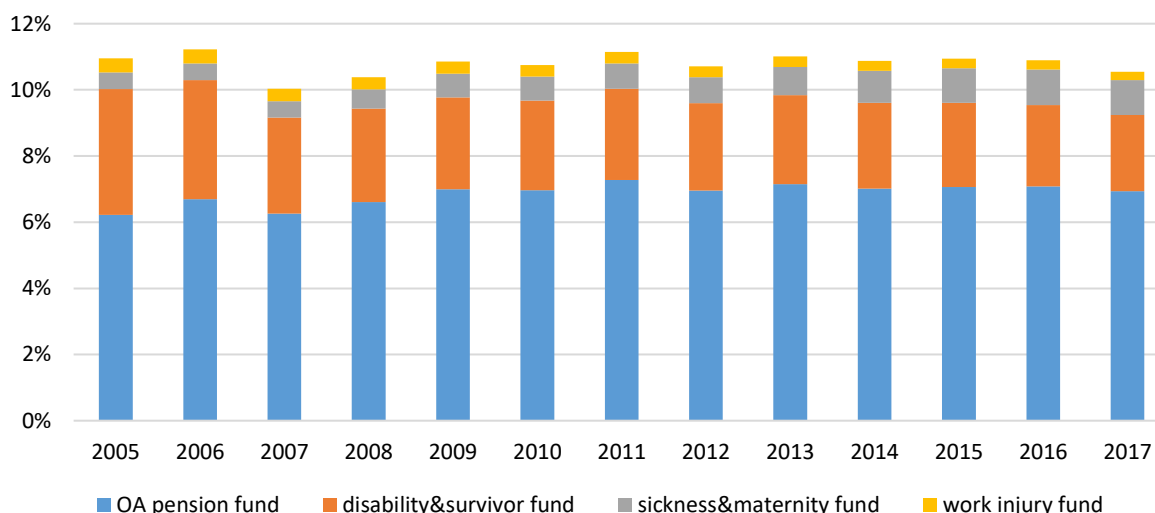
Source: ESSPROS, Statistical annex on financing social protection: levels and structure (2005-2016)

Below, the evolution of social protection spending is further explained using national data.

### 1.2.1 Expenditure from Social Insurance Fund, including old-age pensions

The largest social protection scheme in Poland is the general social insurance scheme, covering employees and self-employed people. Benefits in this system are financed from the Social Insurance Fund (*Fundusz Ubezpieczeń Społecznych* – FUS). It is the public fund that finances pensions and other social insurance benefits for employees and self-employed. Between 2005 and 2017 FUS expenditure ranged between 10 and 11% of GDP. The largest part was on old-age pensions; this remained stable at around 7% of GDP over the period examined (Figure 7).

**Figure 7. Benefit expenditure in Poland from Social Insurance Fund by function, 2005-2017 (% of GDP)**



Source: Authors' calculations based on Social Insurance Institution data.

There are also other, smaller old-age schemes covering specific occupational groups. Farmers have a separate insurance scheme (Farmers Social Insurance Fund – *Kasa Rolniczego Ubezpieczenia Społecznego* – KRUS). KRUS old-age pension expenditure is around 0.6% of GDP.

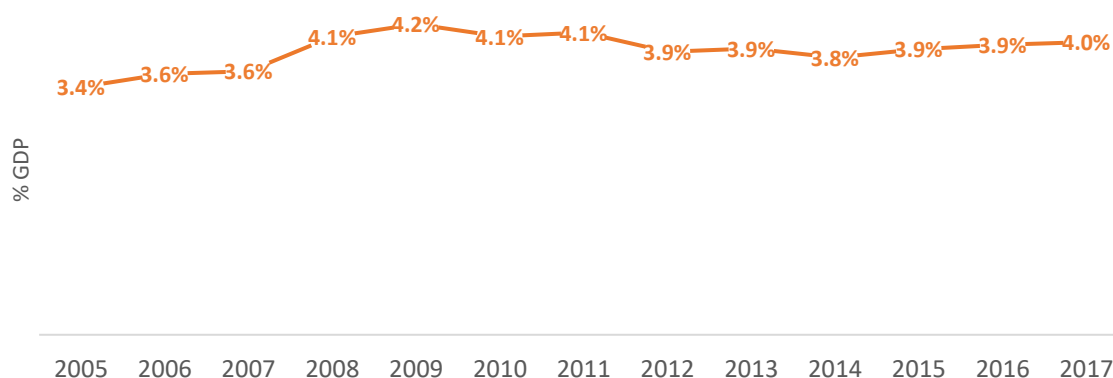
There are also separate schemes for the armed forces, police, judges and prosecutors, which are fully financed from the state budget. Pension expenditure by these schemes is around 0.6% of GDP.

### 1.2.2 Health and sickness expenditure

Most spending in this area relates to healthcare services financed from the National Health Fund (*Narodowy Fundusz Zdrowia* – NFZ), which was stable at around 4% of GDP in 2005-2017 (Figure 8).

The cost of sickness and maternity benefits financed from social insurance more than doubled between 2007 and 2017, from 0.5% of GDP to 1.06%. This growth was related mainly to the extension of the maternity leave period.

**Figure 8. Cost of healthcare benefits in Poland from National Health Fund (2005-2017, % GDP)**



Source: Author's estimates based on National Health Fund data.

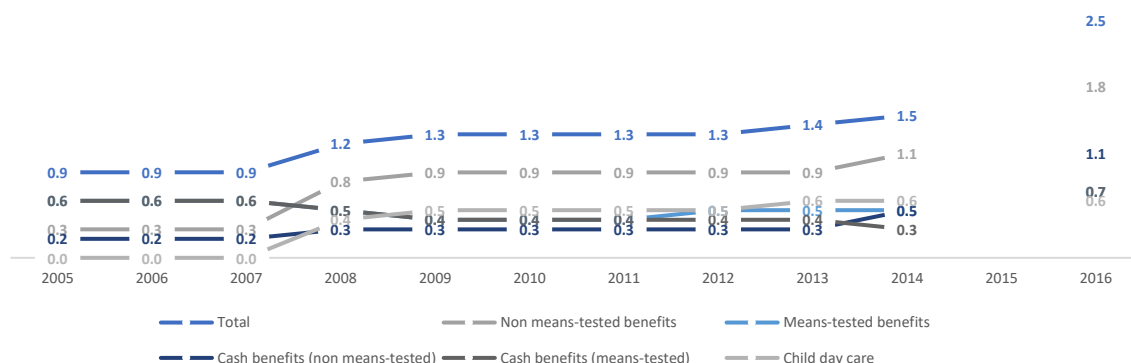
### 1.2.3 Family benefits

Family benefits in Poland cover social insurance benefits (maternity and parental benefits), tax-financed cash benefits (including the birth grant, parental family benefits, family and children allowances) and benefits in kind. In the period between 2005 and 2016 social protection expenditure on family-related benefits increased by 2.5 times (Figure 9).

Between 2005 and 2016 three distinct periods can be identified. First, between 2005 and 2008, family spending was below 1% of GDP, mainly in the form of means-tested benefits. The second period, between 2008 and 2015, marked the gradual expansion of family benefits, including increased access to childcare services (increased financing of pre-school education by local governments and reduced private financing). During this period, expenditure on non-means-tested cash benefits increased from 0.3% of GDP to 1.1% of GDP. The third period started in 2016 with the expansion of non-means-tested cash benefits, with the introduction of the 'Family 500+' benefit. As a result, total expenditure on family benefits rose to 2.5% of GDP in 2016; 1.8% of GDP went on non-means-tested benefits, including 1.1% of GDP on cash benefits. Expenditure on means-tested cash benefits also increased from 0.3% of GDP in 2014 to 0.7% of GDP in 2016 after including the 'Family 500+' benefit for the first child, which is means-tested. As a result, overall family spending in 2016 (2.5% of GDP) slightly exceeded the EU average (2.4%).

As family benefits are financed from general government (tax) revenue, the rise in expenditure on family benefits contributed to maintaining the share of general government tax revenue in social protection spending.

**Figure 9. Social protection expenditure in Poland: family/children function (% GDP), 2005-2016**

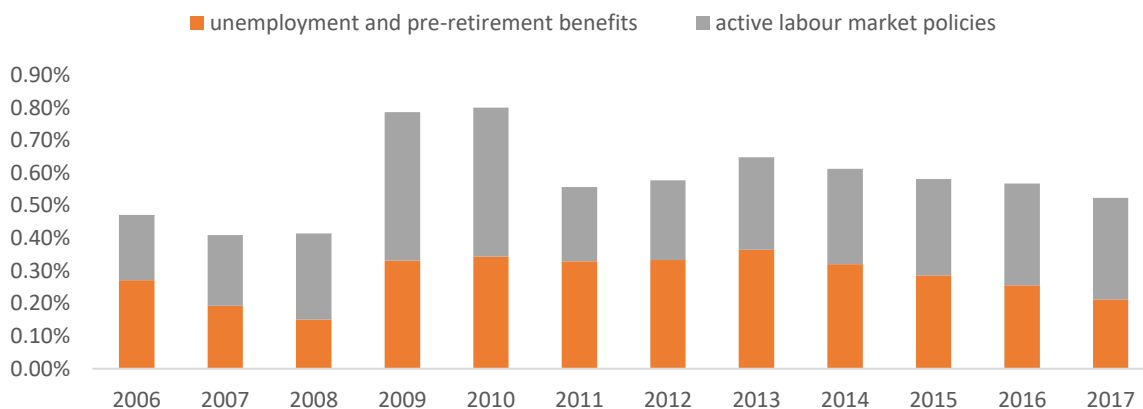


Source: Eurostat, ESSPROS tables; no data for 2015.

### 1.2.4 Unemployment

Expenditure on unemployment (particularly unemployment and pre-retirement benefits) fell relative to GDP between 2013 and 2017, following the overall fall in the unemployment rate in Poland (Figure 10). It is also worth noting higher expenditure on active labour market policies (ALMPs) in 2009-2010, which reflected the special measures taken at the time of the economic slowdown.

**Figure 10. Unemployment spending and contribution revenue in Poland (2006-2017, % GDP)**



Source: Author's estimates based on Ministry of Family, Labour and Social Policy data.

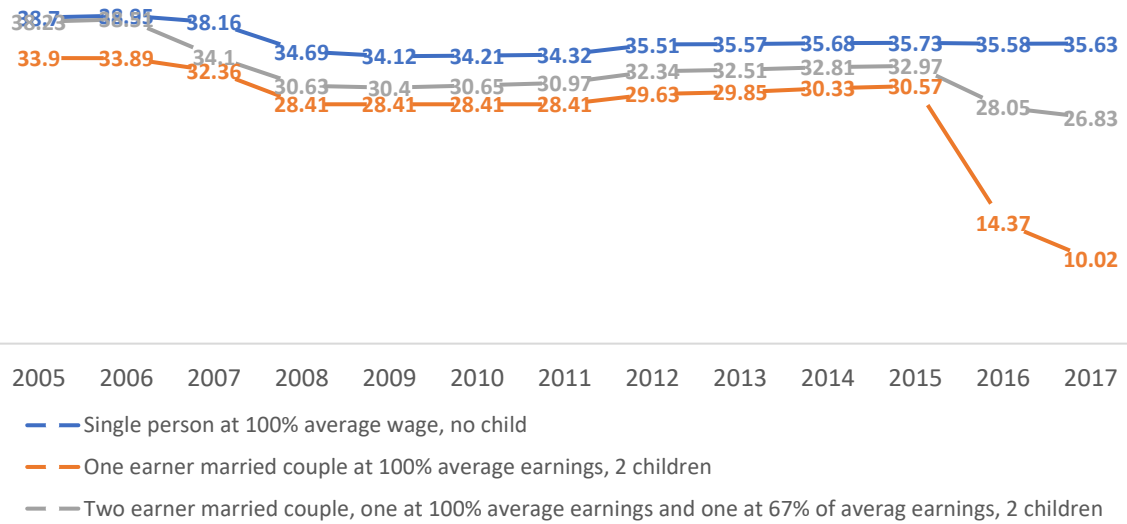
### 1.3 Tax wedge and tax concessions

Tax expenditure, that is tax allowances or tax concessions which reduce the amount of tax payable, amounted to 0.4% of GDP in 2016 (which was similar to the EU-28 average of 0.5%).

The evolution of tax concessions and family benefits in recent years strongly affected the tax wedge for families with children (Figure 11). In 2016-2017 it declined significantly, which was related to developments in the family policy, in particular the new 'Family 500+' benefit. As underlined by the OECD (OECD, 2018), child-related benefits and tax provisions tend to reduce the tax wedge for workers with children compared with the

average single worker. This differential in Poland (25.6 percentage points in 2017) was greater than the OECD average (9.8 percentage points).

**Figure 11. Average tax wedge in Poland by the type of the household (2005-2017, %)**



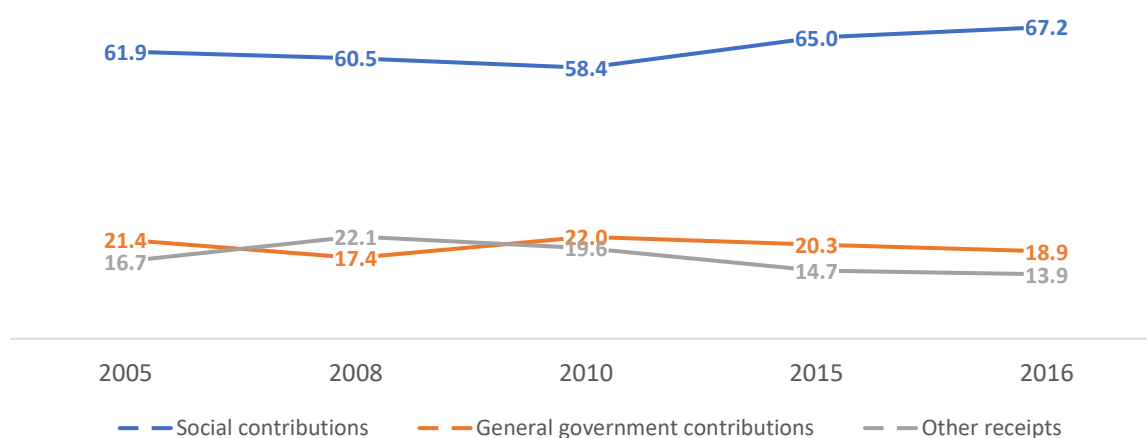
Source: OECD, Taxing Wages Database.

## 2 Current mix and past changes in the sources of financing social protection

More than two thirds (67.2%) of social protection receipts in Poland were from social contributions in 2016, which was above the EU-28 average (54.5%). General government contributions provided 18.9% of total financing in 2016 (compared with 40.4% in the EU-28), while other receipts provided 13.9% of total financing (much more than the EU-28 average of 5.1%).

After 2010 the share of social contributions in financing social protection in Poland increased, after a decline observed between 2005 and 2010 (Figure 12). Conversely, the share of general government contributions and other receipts declined between 2010 and 2016. Around two thirds of contribution income (47% of total financing) in 2016 was paid by employers and 19.9% by employees, with small share (0.4%) paid by benefit recipients.

**Figure 12. Division of financing for social protection in Poland by main source, 2005-2016 (% total financing)**



Source: Statistical annex on financing social protection: levels and structure (2005-2016).

The system of social contributions and taxes levied on wages is quite complex, with social insurance contributions for different purposes comprising most of the tax wedge. There are eight different types of contributions levied on employers, employees and self-employed people, which correspond to different functions of social protection plus income tax, as shown in Table 2 below.

Social insurance contributions are levied on wages earned under a labour contract or civil contract and on self-employed people. There is a ceiling for contributions paid for old-age, disability and survivor contributions of 250% of average wages (in 2018, the Parliament tried unsuccessfully to remove the ceiling, but there are still considerations to do so).

Revenue from selected contributions and their role in financing social protection benefits is discussed below.

**Table 2. Composition of monthly social contributions paid by employees and employers in Poland (as of 2019)**

Gross salary:	5,000.00 PLN			
Net salary:	3,461.95 PLN			
	<b>Employee</b>		<b>Employer</b>	
Old-age	9.76%	488.00 PLN	9.76%	488.00 PLN
Disability and survivor	1.50%	75.00 PLN	6.50%	325.00 PLN
Sickness and maternity	2.45%	122.50 PLN		
Work injury			1.67%	83.50 PLN
Healthcare (calculated on the basis of gross salary less social insurance contributions paid by employee)	9.00%	388.31 PLN		
Personal income tax (less 7.75% of healthcare contribution)	19.00%	464.24 PLN		
Labour Fund			2.30%	115.00 PLN
Solidarity Fund of Supporting People with Disabilities			0.15%	7.50 PLN
Employee Benefit Guarantee Fund			0.10%	5.00 PLN

Source: Authors' calculations.

## 2.1 Social insurance benefits financing

The social insurance system is financed primarily from contributions paid by employees and employers, as well as transfers of assets accumulated from earlier contributions and subsidies from general government (taxes). The share of contributions in financing social insurance spending varied between 2005 and 2017.

The fall in the share of social contributions between 2008 and 2013 was related to modifications of contributions for disability and survivor purposes<sup>2</sup> (Figure 13a).

An increase in the share of social contributions after 2012 was caused by changes in the split of old-age contributions between the non-funded (non-financial defined contribution, NDC) and funded (financial defined contribution, FDC) components of the old-age system. In 2011, the contribution to the FDC account was reduced to 2.3% and the remaining 5% was transferred to the NDC-2 account. From 2015 the contribution to the NDC-2 account was also set at 4.38% or 7.3% of wages, depending on decisions on savings in the FDC part. Those still contributing to the FDC account credit their funded accounts with 2.92% of their wages. All these changes led to increased revenue from contributions and, therefore, an increased share of contributions in financing social protection.

After 2016, contribution revenue also increased due to the expansion of coverage. The rules on social insurance coverage for workers under civil law commission contracts were aligned with those applicable to employment contracts based on the labour code<sup>3</sup>. The new principle of a minimum base for social insurance, equal to the minimum wage, was introduced. If an employee is covered by more than one contract with remuneration below the minimum, contributions are paid on the basis of all relevant contracts, up to the required minimum (for details see Chłoń-Domińczak, Sowa, & Topińska, 2017). However, it is difficult to assess the exact impact of this solution, as it led both to the transformation of civil law contracts to labour contracts and to increased revenue from contributions paid on civil contracts.

Despite these developments, as can be seen from Figure 13b, contribution revenue was not sufficient to finance social insurance expenditure. This meant that an additional state

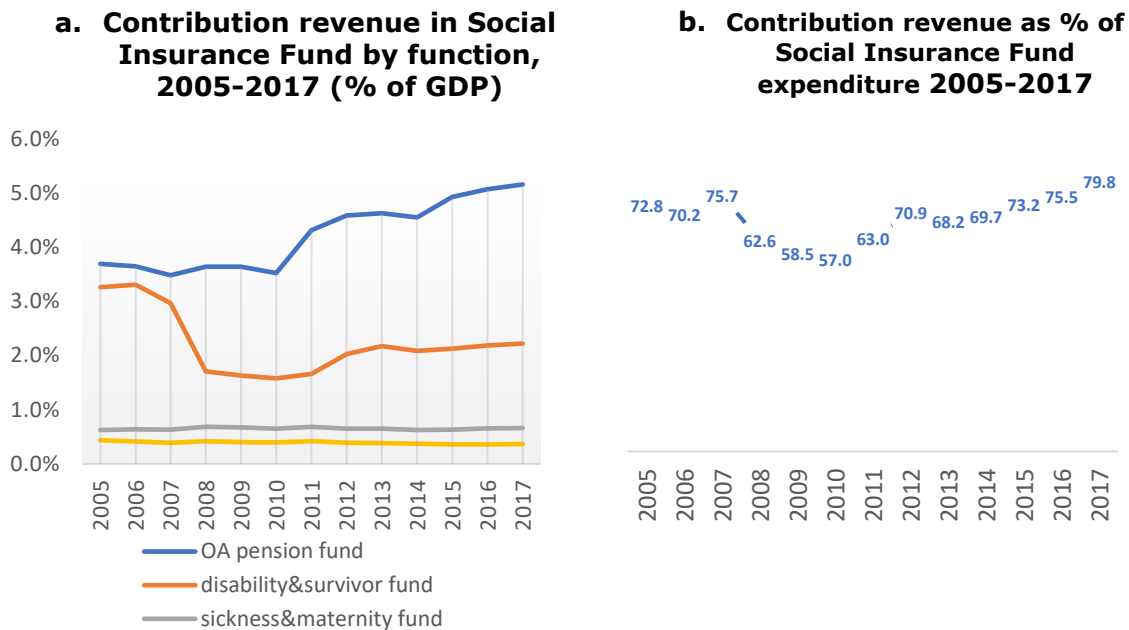
<sup>2</sup> Discussed in detail in Section 2.3 below.

<sup>3</sup> The Act of 23 October 2014 amending the Act on the social insurance system and other Acts (Dz. U. from 2014 item 1831).



budget subsidy financed from general government taxes or other receipts (such as transfers from FDC accounts or the Demographic Reserve Fund) were needed to finance social insurance expenditure.

**Figure 13. Contribution revenue in Social Insurance Fund 2005-2017**

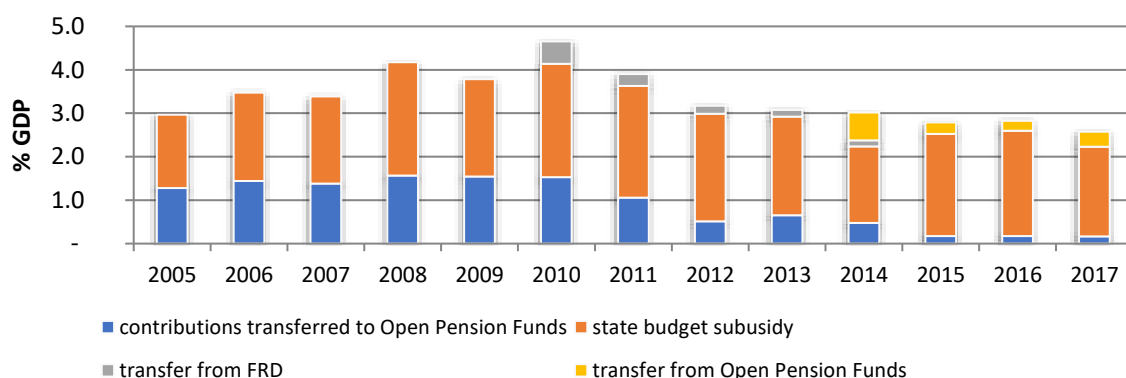


Source: Authors' calculations based on Social Insurance Institution data.

There are two parts to the general government subsidy: (i) a subsidy that compensates for the outflow of contributions to open pension funds (the funded part of the mandatory pension scheme); and (ii) a supplementary subsidy compensating for the deficit in the old-age pension system (that is the tax revenue). Furthermore, the old-age pension fund of the FUS receives transfers from open pension funds corresponding to part of the assets of future pensioners, which are being transferred 10 years prior to reaching retirement age. It can also receive transfers from the Demographic Reserve Fund.

The total amount of subsidies and above-mentioned transfers declined from above 4.5% of GDP in 2010 to above 2.5% of GDP in 2017 (Figure 14). Among these sources of non-contributory revenue, the dominant part was the supplementary state budget subsidy. This subsidy is transferred to the Social Insurance Fund and cannot be distributed between separate social insurance risks (that is, old-age, disability, survivors, sickness, maternity and work injury).

**Figure 14. Non-contributory revenues of Social Insurance Fund in Poland, 2005-2017**



Source: Author's estimates based on Social Insurance Institution data.

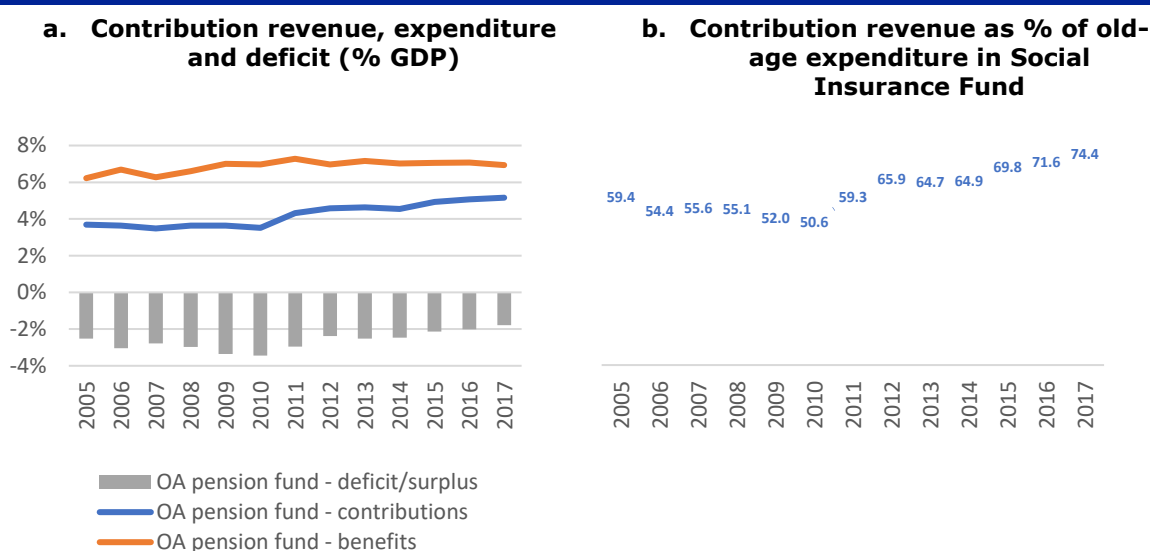
The old-age pension contribution is the largest component of the social insurance contribution. It amounts to 19.52% of gross wages and it is split equally between employees and employers. Self-employed people pay the full old-age contribution based on their declared income (60% of average wages).

The old-age contribution revenue exceeded 5% of GDP during 2011-2017, which left a deficit compared with expenditure of 1.78% of GDP in 2017.

This means that the need for subsidising the social insurance system is linked mainly to the deficit observed in old-age social insurance. The contribution revenue for old-age remained below total old-age expenditure throughout 2005-2017 (Figure 15a). However, in the most recent years the role of contribution revenue in financing old-age pensions increased – from 50.6% in 2010 to 74.4% in 2017 (Figure 15b). This was a result of changes in the contribution split between the NDC and FDC parts of old-age insurance, namely lower contributions paid to the FDC account as well as making this part of the old-age scheme voluntary. As a result, contributions for the majority of workers are paid only to the NDC accounts.

This also means that, in the future, pension payments will be made only from the NDC part of the system and not from pension savings as initially envisaged in the 1999 pension reform. As a result, the reliance of the old-age pension scheme on social contribution financing will continue.

**Figure 15. Old-age part of Social Insurance Fund: revenue and expenditure, 2005-2017**



Source: Author's estimates based on Social Insurance Institution data.

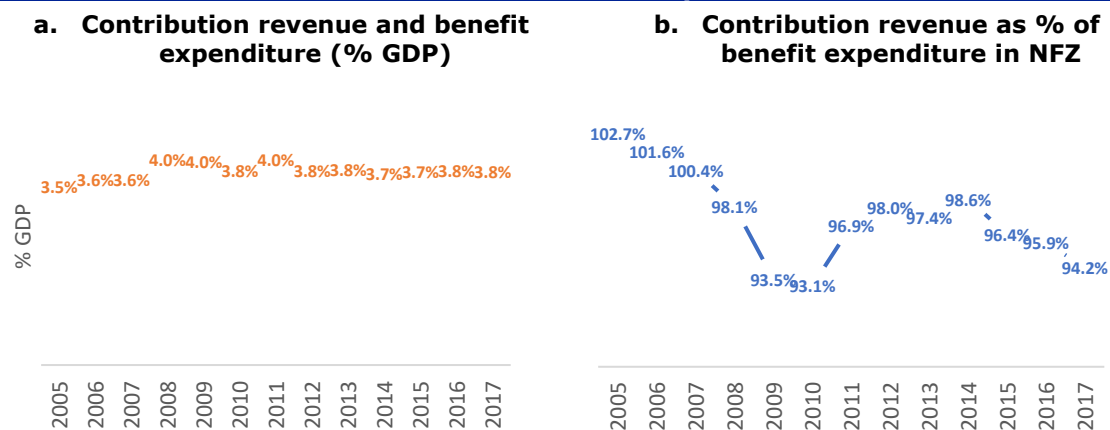
In the KRUS system, farmers pay small social insurance contributions and the benefits are mainly financed from general government tax subsidies. The share of contributions in financing KRUS pension benefits (including old-age, disability and survivor pensions) was 9.1% in 2017. In the 2007-2017 period it varied between 9.1% and 10.7%.

## 2.2 Healthcare financing

The healthcare system in Poland is financed mainly from a contribution that amounts to 9% of the contribution base. The latter consists of wages and other labour income received by working people, but also cash benefits (such as pensions) received from public funds. Contributions are paid by working people or beneficiaries. Employers do not participate in financing healthcare in Poland, with the exception of financing mandatory health checks for their employees (both an initial check prior to employment and regular checks during the employment period). There is also a small element of state budget

financing of selected health programmes. Health contributions are paid over to the separate NFZ. Healthcare contribution revenue in 2017 amounted to 3.8% of GDP (Figure 16a). Contribution revenue almost fully covered expenditure on healthcare benefits during 2005-2017 (Figure 16b).

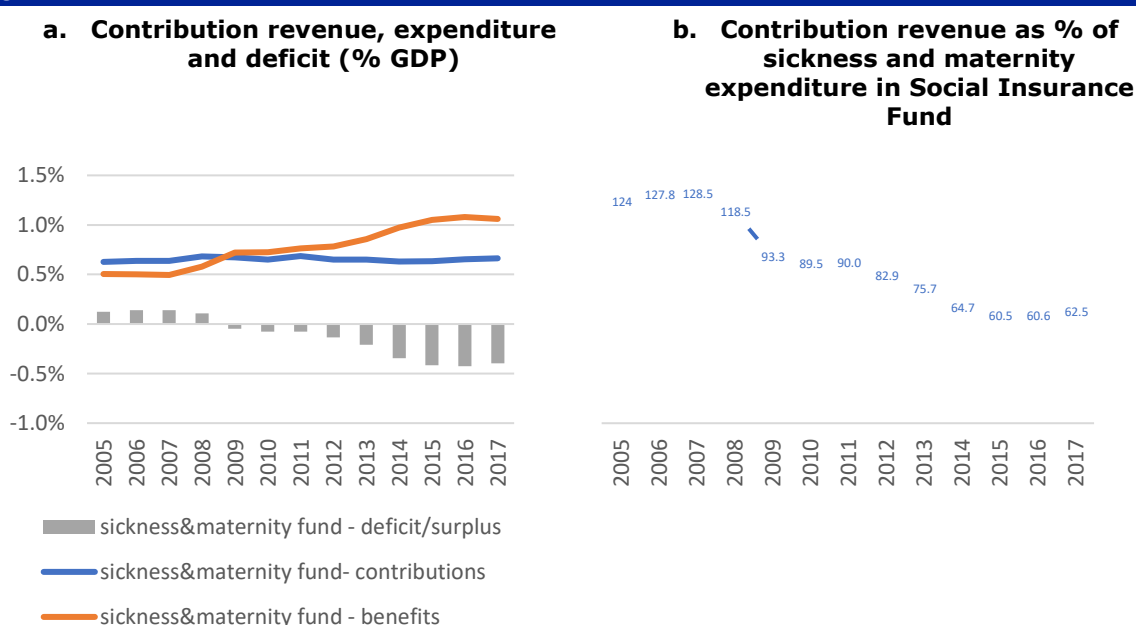
**Figure 16. Healthcare in Poland: revenue and expenditure, 2005-2017**



Source: Author's estimates based on National Health Fund data.

The financing of healthcare also covers sickness and maternity benefits, which are financed from social insurance schemes (the FUS and KRUS). Between 2007 and 2017, sickness contribution revenue (2.45% of wages, paid only by employees) relative to GDP remained at the same level (slightly above 0.6%) as shown in Figure 17a. Due to the rising cost of benefits for sickness and maternity, the share of contribution financing in this part of the social insurance system dropped from more than 100% before 2008 to 62.5% in 2017 (Figure 17b).

**Figure 17. Sickness and maternity financing in Social Insurance Fund, 2005-2017**



Source: Author's estimates based on Social Insurance Institution data.

## 2.3 Financing of other functions of social protection from social contributions

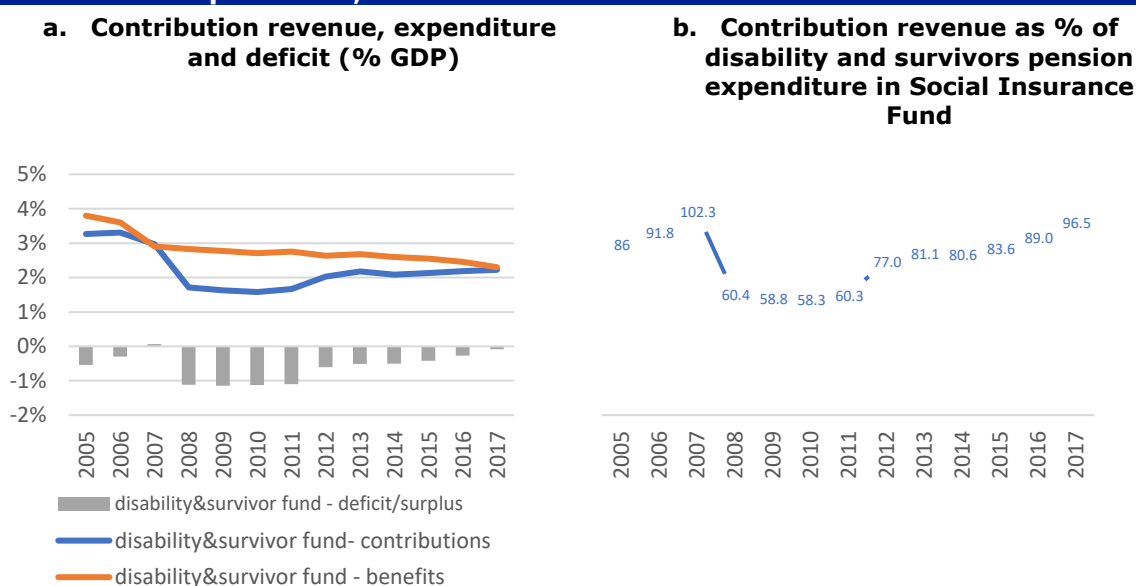
### 2.3.1 Disability and survivor pensions

Like old-age pensions, disability and survivor pensions are financed from three separate sources: ZUS, KRUS and social protection schemes for the armed forces/police, judges and prosecutors.

In the ZUS scheme, both employers and employees finance the disability and survivor contribution. The total contribution is 8% of wages and is split unequally (1.5% paid by employees and 6.5% by employers).

This part of the social insurance contribution was subject to several changes, as indicated in the previous Section. Between 1999 and June 2007 it was set at the level of 13% of wages, split equally between employees and employers. From July 2007 until December 2007, it was 10% (3.5% paid by employees and 6.5% by employers). From 2008 until 2012 it was further lowered to 6% (1.5% employees, 4.5% employers). From 2012 it was increased to the current 8%. As a result, the share of contribution revenue in financing disability and survivors' pensions declined between 2008 and 2011 to around 60% and from 2012 it gradually increased to 96.5% in 2017.

**Figure 18. Disability and survivor pensions part of Social Insurance Fund: revenue and expenditure, 2005-2017**

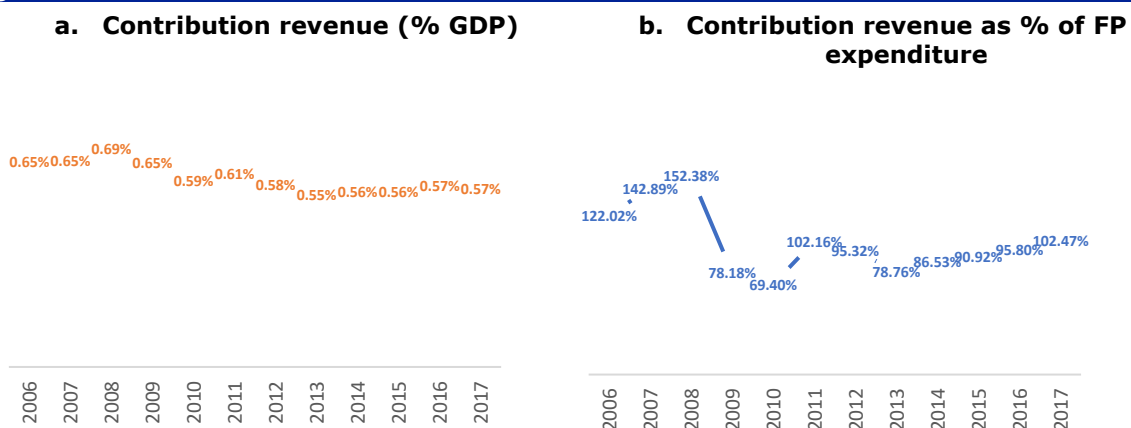


Source: Author's estimates based on Social Insurance Institution data.

### 2.3.2 Unemployment

Unemployment expenditure is financed from the contributions paid by employers, amounting to 2.45% of gross wages, to the Labour Fund (*Fundusz Pracy* – FP). Between 2005 and 2008 contribution revenue was much higher than expenditure on benefits and ALMPs (Figure 19). In 2009-2010 the expenditure on both benefits and ALMPs increased during the economic slowdown, which led to a deficit in the FP. After the financial situation was stabilised in 2011-2012, a further slowdown in the labour market led to further annual deficits. However, in 2017, contribution revenue to the FP (0.57% of GDP) was once again higher than expenditure on benefits and ALMPs (0.54% of GDP).

**Figure 19. Contribution revenue of the Labour Fund**



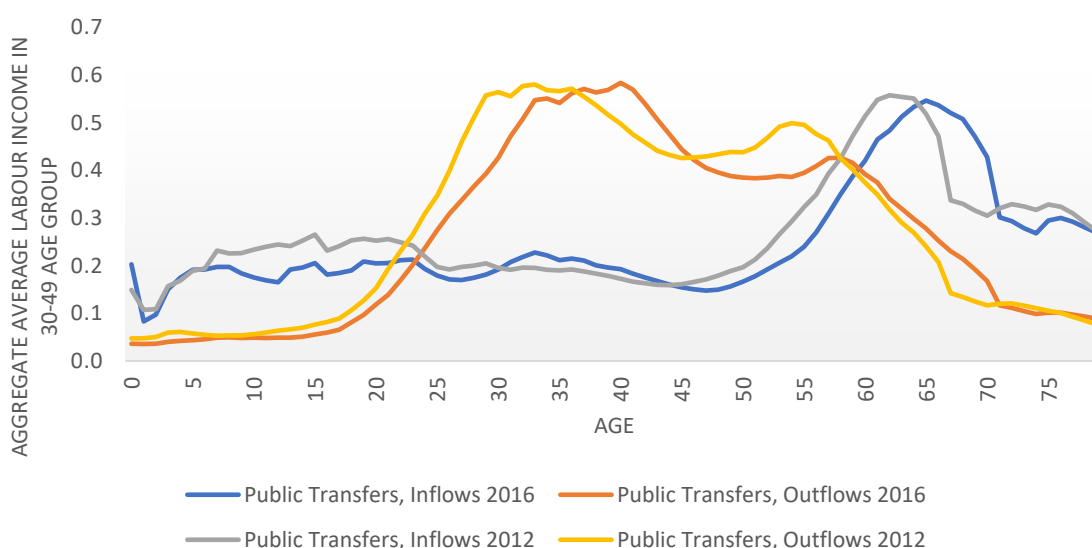
Source: Author’s estimates based on Ministry of Family, Labour and Social Policy data.

### 2.4 Public transfers inflows and outflows by age

The dominant role of social contributions in financing social protection in Poland also affects the age distribution of public transfers (inflows and outflows), which can be observed using the National Transfer Accounts (NTA) method. The NTA was developed by professors R.D. Lee and A. Mason to observe the age dimension related to consumption, labour income and private/public flows in the economy (including education). This approach is fully consistent with national accounts (for more see Lee & Mason, 2011).

Figure 20 presents the age profiles of aggregate public transfer flows in Poland in 2012 and 2016. It illustrates the heavy reliance of public transfers on social contributions. Public transfer outflows were mainly attributable to working-age cohorts, as social contributions are levied to a large extent on aggregate labour income. Public transfer outflows were paid to a large extent by the most numerous cohorts (those born in the 1980s baby-boom period as well as the post-war baby-boom cohorts), particularly in 2012.

**Figure 20. Age profiles of aggregate public transfers, inflows and outflows, in Poland (2012 and 2016)**



Source: National Transfer Accounts database for Poland, 2012 and 2016.

The change in the age profile of aggregate public transfer outflows between 2012 and 2016 shows the impact of the changing age structure of the working-age population. Due to the declining size of cohorts reaching working age, combined with postponed labour market entry caused by higher participation in higher education, aggregate public transfer outflows of people below age 40 (relative to aggregate wages of the prime-aged generation, that is those in age group 30-49) were lower. At older ages public transfer outflows were higher for the baby-boom generation born around the 1980s and again for people in the age group 60-65, which reflects the impact of the increased retirement age and longer working lives.

The age profile of public transfer inflows shows that the group receiving the highest transfers were those aged 55 and over. These include pension transfers as well as healthcare received by this group. The shift of this age profile to the right for the age group 45 and over also reflects postponed retirement.

It is also worth noting that between 2012 and 2016 aggregate public transfer inflows received by those aged below 30 declined, both due to the lower size of this age group, but also lower per capita transfers (relative to wages).

### **3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic**

The Polish welfare state model resembles most the 'conservative-corporatist' model (Esping-Andersen typology) (Siemieńska & Domaradzka, 2016). Social rights and social support are strongly connected with labour market status and the bulk of the financing for social protection is linked to social contributions, particularly for old-age pensions and healthcare. As underlined by Siemieńska & Domaradzka (2016) the social policy model that emerged during the 25 years of economic and political transition can be characterised as mixed. It is dominated by social insurance providing employment-related benefits, supplemented by means-tested benefits. After 2008, there was an increasing role for non-means-tested family benefits. The introduction of the new 'Family 500+' benefit increased the share of social protection spending going on universal non-means-tested transfers, financed from taxes. However, it did not affect the share of spending on the largest items.

There are also significant asymmetries related to the recipients of social protection expenditure. The old-age generation benefits more than the young one, which is also underlined by social policy researchers in Poland (for example Auleytner, 2017). It should be noted that education expenditure is excluded from this analysis.

The scale of public finance revenue in Poland reflects the fact that the tax burden is lower than in the EU, while the social contribution burden is higher than in the EU. The reliance on social contributions in financing social protection means that there are several risks to the stability of the system. First, there is a persistent risk related to evasion of contributions, such as through bogus self-employment or the use of non-standard contracts. Although legal changes in Poland in recent years have sought to reduce the scale of this phenomenon, such as by widening the base for mandatory social contributions paid on civil contract income, it remains an important issue on the policy agenda. Second, financing social protection from social contributions leads to exposure to demographic risks. The changing age structure of the population and, in particular, the transition of the post-war baby-boom generation from employment to retirement already affects aggregate public transfer inflows and outflows. In the longer run, following the phasing-in of the new old-age pension system benefits, relative expenditure on old-age benefits is likely to decline, but the risk of poverty among older people is also expected to increase.

Although the share of social contributions in total social protection spending increased towards the end of the period examined, it is worth noting developments within different social protection functions. The overall increase in the significance of social contributions can be attributed to their greater role in financing old-age pensions, particularly following the increase in the disability pension contribution and changes in the split of old-age pension contributions between the NDC and FDC parts of the old-age scheme. This means that social insurance is less reliant on the state budget subsidy. The growth in contribution revenue, combined with a decline in disability pension spending, also reduces the need for tax-financed subsidies. However, in the future, old-age pensions will entirely rely on the NDC system.

As the tax wedge caused by social contributions is high in Poland, a further expansion of this source of financing is not supported. For example, a proposal to establish a new long-term care social insurance scheme did not receive support. Attempts to reduce social contributions (such as the 2008 cut in the disability contribution) show that such policies need to be carefully examined in order to avoid further reversals.

The declining role of general government subsidies in financing social insurance expenditure (particularly old-age pensions and other pensions) helped to finance new social policy instruments addressed at families, in particular the 'Family 500+' benefit, – reflecting the rising importance of family policy in recent years (partly also a response to the declining number of births). Family benefits and services in Poland are financed

predominantly from taxes, and their expansion contributed to maintaining the share of taxes in financing social spending, despite developments in the social insurance system.

Finally, the design of social protection financing in Poland means that the main provider of social services in Poland is central government, followed by local and regional governments (Siemieńska & Domaradzka, 2016). Although the role of the latter is increasing, there is little knowledge of their capacity to help solve social problems (Auleytner, 2017).

The evolution of social protection expenditure and its sources of financing are an outcome of both policy reforms introduced in recent years and past reforms and economic outcomes. Recent policy developments are primarily as follows.

- An expansion of family policy, leading to an increase in social protection expenditure on families, financed mainly from taxes. These include an expansion of childcare with reduced costs for families, and the universal 'Family 500+' benefit introduced in 2016. In 2019, the government announced a further expansion of this benefit to cover the first child in a family (currently, the benefit for the first (oldest) child is subject to an income test).
- A reduction in the retirement age back to 60 years for women and 65 years for men, which led to an increased number of old-age pensioners and increased expenditure on pensions, as well as reduced income from contributions due to withdrawal of the new retirees from the labour market.
- Changes in the old-age contribution split between the NDC and FDC parts of the old-age pension system, as well as a gradual transfer of pension savings to the NDC part before retirement age, which increased the revenue of the old-age social insurance system and reduced the need for tax-financed subsidies.

The positive labour market situation, namely high wage growth and employment and low unemployment, also influence social protection revenue and expenditure. Higher wages lead to higher social contributions revenue, which means that social protection systems (particularly the FUS) require fewer tax subsidies to finance benefits. A low unemployment rate also led to lower unemployment expenditure. Last but not least, disability expenditure is also falling, which is a continuation of the trend that began with the reforms introduced in late 1990s.

As a result of all these developments, overall social protection spending in Poland relative to GDP remains stable. The reduced need for tax-financed subsidies to the social insurance system is matched by increased tax-financed expenditure in other areas, particularly on family benefits. State spending on education is also declining relative to GDP, with the increased reliance on local government budgets. The sustainability of such policies in the future, particularly during further economic slowdowns, needs to be monitored and assessed.

There are also structural issues that need to be monitored. For example, the expansion of family policy affects the employment of women. According to the estimates of Magda, Kiełczewska, & Brandt (2018) the labour force participation of mothers dropped by 2.4 p.p. after the introduction of these benefits, which also has an impact on overall tax and contribution revenue. With a shorter labour market career and a lower retirement age, women are at risk of high rates of old-age poverty in the future, which would also mean an increased need to finance the minimum pension guarantee from taxes in the future. An assessment of the social benefits system in the broader policy context is needed, as highlighted in the EC Country Report for Poland in 2019 (European Commission, 2019).

There are several policy recommendations that can be formulated for future discussion on financing social protection in Poland. First, with the high reliance on social contributions, it is important to ensure that aggregate labour income increases. This can be achieved by **promoting longer working lives and increased labour market participation**. In particular the **mix of policies should support the reconciliation of work and family lives** and promote female employment. The increase in the retirement



age in Poland between 2012 and 2016 led to increased aggregate labour income of people in the age group 60 to 65. The 2018 reversal of the retirement age increase may have the opposite impact on the age profile of aggregate labour income – introducing effective measures **to postpone retirement decisions** is needed. Another important challenge is lifelong learning policy. It is important **to develop the skills of people**, not only at the initial education level, but also in adult life. Increased productivity and a higher share of skilled workers in employment can also compensate for some of the consequences of population ageing. Another debate concerns the **rising participation by migrants** (particularly from Ukraine) in the labour force, which also means a rising share of social contributions paid by them. However, they comprise less than 5% of the total number of people covered by social insurance in Poland.

Further policy debate is also needed on **diversifying sources of financing for social protection** and **ensuring high social protection coverage**, in the light of changing nature of work, as highlighted in the 2019 World Development Report (World Bank, 2019).

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