

# DUAL LABOUR MARKET IN POLAND – PROPOSALS FOR OVERCOMING THE DEADLOCK

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The report discusses the phenomenon of dual labour market, which in Poland involves abuse of the possibility to hire employees under civil law contracts. The report also proposes solutions aimed at curbing this phenomenon. We propose introducing a so-called single contract, adapted to the Polish specificity, which would make it easier for companies to hire employees in a flexible manner, at the same time opening to employees the door to stable employment. We also call for reducing those employment-related obligations placed on small companies which are not related to protecting employees against dismissal or to their wages, but generate additional costs. Furthermore, we propose reducing the taxation of low earners who are at risk of being forced to work under civil law contracts or self-employment. This can be achieved by increasing the tax deductible expenses and raising the basic income tax rate from 18% to 20%, such change being neutral for the state budget. Our proposals are aimed at finding a new balance between the interests of employers and the needs of workers in Poland.

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# Non-standard forms of employment in Poland and European trends

At the beginning of the 21<sup>st</sup> century, the high level of unemployment was the most severe social problem related to the labour market in Poland. In the recent years, however, the increasing incidence of various forms of employer-worker contracts other than the employment contract has become equally important. Based on the data of the Polish Central Statistical Office (GUS), in 2012 there were 15.6 million workers in Poland, out of whom 9 million were employed under open-ended contracts, 3.2 million – under temporary contracts,<sup>1</sup> while ca. 1.1 million individuals were self-employed outside the agricultural sector and did not employ any workers. According to the Ministry of Finance, in 2012 916 thousand people in Poland worked solely under civil law contracts. Ten years earlier this figure stood at 580 thousand. Based on a survey conducted among firms employing at least 9 workers, GUS (2014b) believes that there were 547 thousand such individuals in 2010, in 2011 this figure rose to 1.01 million, reaching the level of 1.35 million in 2012.

Although GUS and the Ministry of Finance estimates of the number of persons working under civil law contracts are slightly different, both sources indicate an increase in the scale of this phenomenon. Over the last decade, the percentage of workers hired under temporary contracts among all employees has risen significantly – from 11% to 21% (LFS data). In the same period, the share of workers working under open-ended employment contracts has decreased (from 61% to 57%), but so has the unemployment rate – from ca. 20% of the working population in 2002 to 10.3% in 2013. The self-employment ratio increased from

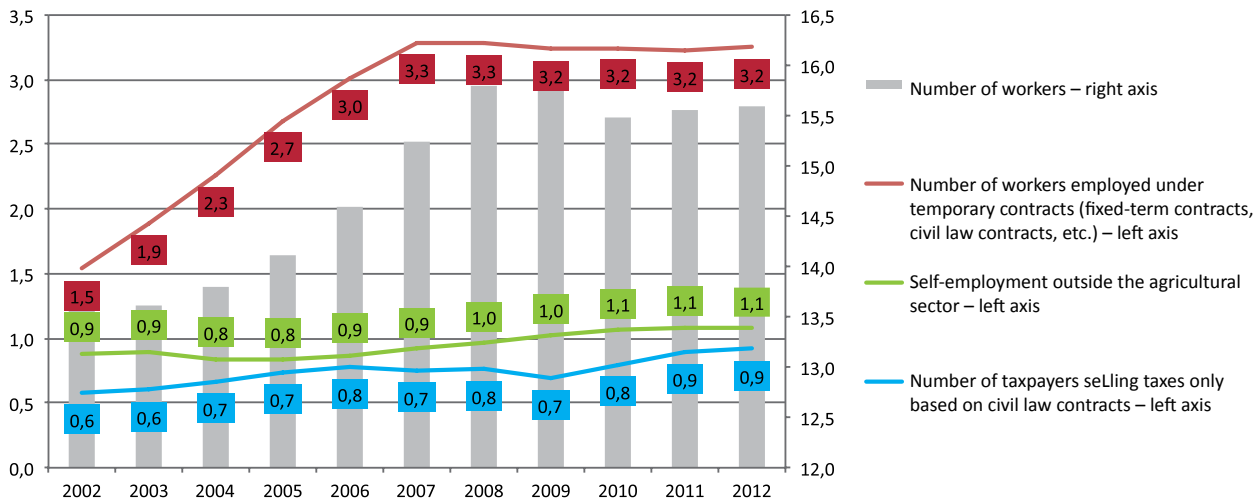
6% of the working population in 2002 to ca. 7% ten years later, and the percentage of persons working solely under civil law contracts – from 4% to 6% of the total working population and to 7% of non-agricultural workers.

Various forms of non-standard employment: telework, temporary work (through a temporary employment agency), part-time work, self-employment, employment for the time of performing a specific work, flexitime, compressed hours or job sharing (dividing the work time between two workers, who jointly perform the work of one full-time worker) are present in most European countries. The Polish labour law also provides for the possibility of “on-call work” (work on duty), substitution employment and flexible working time arrangements. Due to the diversity and specific nature of labour law solutions applied in EU Member States, it is difficult to create an unambiguous list of those methods of contracting labour which could be called particularly atypical forms of employment (Eichhorst et al. 2013). However, Poland stands out in the European Union with the pace of changes in the structure of the employment forms used. In 1998, only 4.7% of workers performed work under contracts that did not ensure stable employment; since that time this share has risen to 26.9%, which is the largest increase among the EU countries. As a result, Poland, along with Portugal and Spain, belongs to a group of countries with a high ratio of persons working under temporary contracts and a moderate level of self-employment.

The term “junk contract” has come to be the symbol of the above-mentioned developments on the Polish labour market. Although it is widely used by the media and in the policy debate, there is no single definition of the term – it is used freely depending on the current context and the intention of the speaker. In the public discourse, it is most often used with reference to contracts imposed by employers who

1 GUS does not differentiate between various types of contracts in this category, so some of those persons may have worked under civil law contracts. Including a precise question on the form of the worker’s contract in the Labour Force Survey questionnaire would dispel many doubts concerning the incidence of civil law contracts in Poland.

Chart 1. Number of persons working under various legal forms in 2002–2012 (in millions)



Source: own elaboration based on the data of Eurostat, GUS and the Ministry of Finance

want to circumvent labour law regulations or reduce the tax wedge, in particular to: civil law contracts (contract of mandate, contract to perform a specified task), in particular if they are used to describe continuous work for one employer; self-employment, for the same reasons; fixed-term employment contracts (temporary contract), e.g. due to lack of job stability and security, which applies in particular to contracts concluded for a very long term, such as 10 years.<sup>2</sup>

Table 1 presents a comparison of the rights of workers employed under a traditional open-ended employment contract with the rights of workers employed under fixed-term contracts, working under a contract to perform a specified task or a contract of mandate, and self-employed workers in Poland. It demonstrates that civil law contracts involve much lower protection of workers against dismissal, lower job security, lack of requirements concerning OHS and appropriate working conditions, lack of holiday entitlement and worse access to social security benefits (e.g. no entitlement to the unemployment benefit). In the case of self-employment, there is no entitlement to holiday due from the employer, although the self-employed person has the right to holiday leave, maternity leave or sick leave. The other side of the coin are legally stipulated costs incurred by the employer and the level of taxation for individual contract types, which have also been presented in Table 1.

<sup>2</sup> According to the Polish Labour Code, the third fixed-term employment contract with the same employer should be converted to an open-ended contract.

Both are much lower in the case of civil law contracts and self-employment than for employment contracts (both open-ended and fixed-term ones).

**For the purposes of this report, the authors define “junk contracts” include contracts of mandate, contracts to perform a specified task or self-employment with a single employer which have the features of regular employment.**<sup>3</sup> A fixed-term employment contract is not necessarily a “worse” form of employment, although concluding such contracts for multiple-year terms is contrary to their spirit and purpose. However, in comparison to the types of contracts listed above, a fixed-term contract, which ensures the payment of social security contributions and a certain notice period (albeit shorter than in the case of an open-ended contract), involves a lower risk of exclusion from full and rightful participation in social and economic life.

<sup>3</sup> The term “junk contract” used in Poland is different from “junk job”, coined in the United States in 1970s–1980s. “Junk job” usually refers to a low-paid job which is mundane, hampers professional development and can be mainly found at the bottom of the professional hierarchy in the services sector (Esping-Andersen 2010). Since the 1990s, the phenomenon of “junk jobs” has also been present in Poland, affecting especially a large number of persons working in retail chains, fast-food restaurants and bars. These jobs may involve work under “junk contracts” if the workers are hired under e.g. civil law contracts, but this is not always the case, as some employers hire workers full-time (or part-time, e.g. for 7/8 or 3/4 of the traditional working time).

Table 1. Legal and economic characteristics of various types of contracts in Poland

	Worker's rights	Employer's costs
Open-ended employment contract (benchmark)	<ul style="list-style-type: none"> <li>• Remuneration paid in specific amount and on specific time. Not lower than the minimum wage established by the government.</li> <li>• Regulated working time (not more than 8 hours a day on average) and not more than 40 hours a week on average. The number of overtime hours may not exceed 150 hours per year, however the total number of hours worked in a week may not exceed 48 hours.</li> <li>• Holiday leave granted to the worker in the amount of 20 working days per year if the worker has been employed for less than 10 years, and 26 working days if he/she has been employed for more than 10 years (including years of full-time education). Additionally, the worker is entitled to unpaid leave.</li> <li>• A woman who gives birth to a baby and, to a certain extent, her partner are entitled to maternity (parental) leave.</li> <li>• Occupational health and safety (OHS) and ensuring appropriate working conditions (lighting, temperature, chair and even subsidy for glasses necessary to work on computer).</li> <li>• Reason for dismissal needs to be stated.</li> <li>• Possibility to file a complaint for unfair dismissal with the Labour Court (and, if the case is won, reinstatement to work).</li> <li>• Notice period: 2 weeks if the worker has been employed for less than 6 months, 1 month if the worker has been employed for at least 6 months, 3 months if the worker has been employed for at least 3 years.</li> <li>• Holiday compensation.</li> <li>• Severance payment in case of redundancy.</li> <li>• Membership in a trade union.</li> </ul>	<p>The non-payroll cost of work in the case of employment contracts amounts to ca. 38.5-41% of the total costs of employing the worker. The employer pays a half of the retirement insurance (amounting to 19.52%) and the greater part of the pension insurance (8%), accident insurance (0.67-3.86% depending on the number of workers), a contribution to the Labour Fund (2.45%) and the Employees' Guaranteed Benefits Fund (0.1%). The worker pays the remaining part of the retirement and pension insurance contributions, sickness insurance (2.45%) and health insurance (9%) contributions, plus the income tax prepayment (19%). The individual contributions do not add up, as they are calculated on different bases. In the case of some high-risk occupations, contributions are also paid to the Bridging Pension Fund in the amount of 1.5% of the remuneration.</p> <p>Social security contributions are paid on account of the first contract signed by the worker – other contracts are not subject to social security contributions, unless they are also employment contracts (or are concluded with the same employer).</p> <p>The costs related to the obligation to notify the employee in writing (affecting particularly small companies): of the standard daily and weekly working time, leave and notice period, work regulations if the company is large enough, about non-discrimination against workers, etc. this is increased by the costs of OHS training and medical check-ups.</p>
Fixed-term employment contract	The same as for an open-ended contract, only the contract expires on a specific date.	The same as for an open-ended contract.
Contract of mandate	<ul style="list-style-type: none"> <li>• If the work is to be performed on the employer's premises, the employer has to provide workspace for the worker.</li> <li>• A woman who gives birth and, to a certain extent, her partner are entitled to maternity (parental) leave (provided that voluntary sickness insurance contributions are paid, which is only possible if retirement and pension insurance contributions are paid).</li> <li>• Right to pension, sickness benefits (see above).</li> </ul>	The employer does not pay any contributions provided that the contract is not the only title to insurance (otherwise the employer has to pay them all). In the case of a contract of mandate, the contributions amount to 37.6-39% of the entire cost of work (depending on whether the worker wishes to pay the sickness insurance contribution). In such a case, the employer pays only the retirement, pension and health insurance contributions. Some employees, e.g. students or members of supervisory boards, are exempted from the payment of contributions.
Contract to perform a specified task	None (as compared to benchmark)	9-14.4% of the costs of work is tax (depending on whether the work is subject to transferable copyright). <sup>4</sup> The employer does not pay any contributions, including health insurance.
Self-employment	No entitlement to holiday due from the employer, but the self-employed person has the right to holiday leave, maternity leave etc. or sick leave.	<p>A characteristic feature of contributions collected from self-employed individuals is that they are assessed on the basis of a fixed amount, not dependent on the actual income of the entrepreneur.</p> <p>The contributions are calculated as a percentage of the base amount declared by the entrepreneur, which, however, may not be lower than 60% of the forecast average monthly remuneration accepted for determining the limitation amount of the annual contribution assessment basis. Within the first 24 calendar months from the day of business activity commencement this basis is a declared amount, not lower than 30% of the minimum wage amount.</p>

Source: Own elaboration.

<sup>4</sup> Generally, the tax deductible expenses, which decrease the taxable income, amount to 20%, but if the subject of the contract is a copyright, a licence etc., they may amount to 50%, both in the case of a contract to perform a specified task and an employment contract.

# Labour market duality in Poland

## SYMPTOMS OF LABOUR MARKET DUALITY IN POLAND

On account of the different regulations, rights and costs related to employment contracts and other forms of employment, the popularisation of the latter creates the risk of emergence of the so-called labour market duality in Poland. This phenomenon consists in the co-existence of two segments, with workers in one segment being more privileged than those in the other. This situation has a number of consequences, both for workers performing the “worse” jobs described above, mainly young people, and for the whole economy:

- Lower remunerations and higher risk of poverty – persons working under temporary contracts earn less than workers with similar qualifications employed under open-ended contracts, particularly if they are among the lowest earners in the economy (Fournier and Koske 2012). According to OECD analyses (2012), the average difference in earnings due to contract type, i.e. excluding the impact of the number of working hours, education, age or sex, varies between 15% and 40% (ca. 30% in Poland). Lewandowski and Kamińska (2014) demonstrate that the poverty indices among persons

working under temporary contracts (outside the agricultural sector) are three times higher than among persons working under open-ended contracts; even if we allow for other factors, temporary contracts involve a higher risk of poverty than open-ended contracts (this does not apply to self-employment).

- Less job stability – according to EU-SILC data, fewer than 30% Poles employed on a temporary basis were offered stable employment after a year, and fewer than 50% of individuals aged 18-29 had stable employment three years later (Eurofound 2013). The Social Diagnosis 2013 survey shows that individuals who were working under fixed-term contracts in 2011, suffered from almost three times higher risk of being unemployed in 2013 than persons who in 2011 were working under open-ended contracts (9.2% and 2.8%, respectively), and were half as likely to be working under an open-ended contract (36% and 79%, respectively). The unemployment risk among persons who in 2011 were working under short-term or civil law contracts was even higher in 2013 (10.6%) and the chances to be working under an open-ended employment contract (27.6%) lower than among persons who in 2011 were working under fixed-term contracts.

Table 2. The form of employment of non-agricultural workers in Poland, aged 25-44, depending on the education level, 2013 (in %).

	Higher	Post-secondary	Secondary	Basic vocational	Primary and lower secondary
Open-ended contract workers	70	63	58	59	46
Temporary workers	18	25	30	31	46
Self-employed	12	12	12	10	8
Total	100	100	100	100	100

Source: Own calculations based on LFS data.

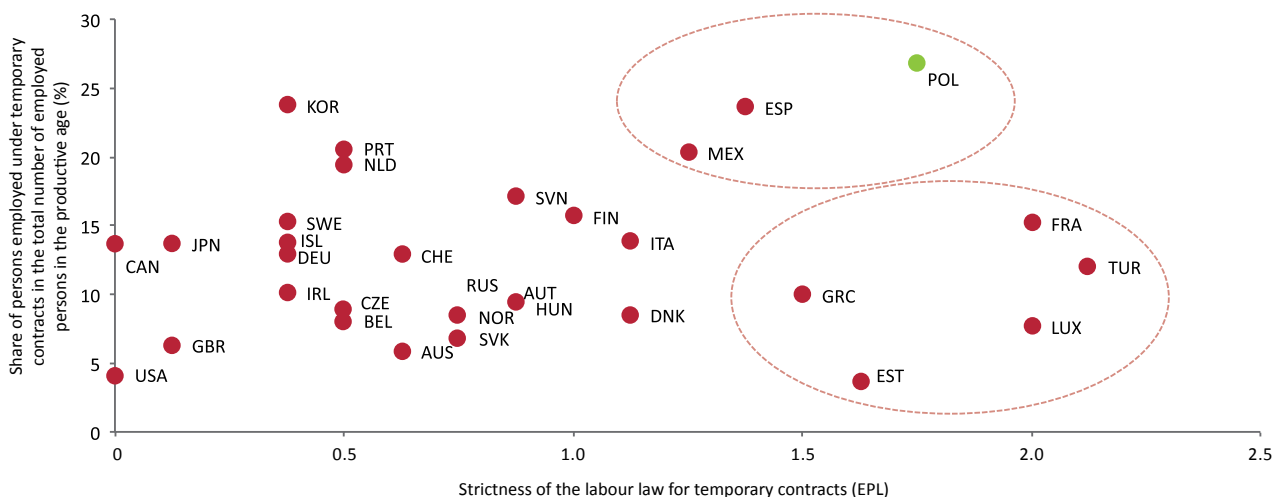
- Worse skill acquisition, promotion and professional development opportunities – on average, persons working under temporary contracts are not as well educated as persons working under open-ended employment contracts. In 2013, among the Polish working population employed outside the agricultural sector, the percentage of individuals with higher education amounted to 38% among workers employed under open-ended contracts, 24% among those working under temporary work arrangements and 37% among self-employed workers.<sup>5</sup> Table 2 shows that the lower the education level, the higher the percentage of temporary workers in a given group. In high-skilled jobs, the percentage of temporary workers is half the percentage of individuals employed under open-ended contracts (30% and 60%, respectively).<sup>6</sup> Furthermore, workers employed under temporary contracts are less likely to participate in professional development and training courses (Chłoń-Domińczak and Lis, 2013).
- In the case of young people, greater difficulties in gaining independence and starting a family. However, Baranowska-Rataj (2011) points out that the key factor influencing the decision to start independent life and leave parents' home is the fact of having a job of any kind.

It should be borne in mind, however, that temporary workers are located between permanent employees and the unemployed. Lewandowski and Kamińska (2014) demonstrate that the presence of a temporary worker in the household reduces the risk of household poverty, although not so much as the presence of a self-employed person,<sup>7</sup> while the presence of an unemployed person significantly increases the risk of poverty. Furthermore, temporary workers are on average a little better educated than the unemployed. According to the Social Diagnosis survey (2013), even among persons who in 2011 were working under short-term or civil law contracts the risk of unemployment in 2013 was over three times lower than among persons who were unemployed in 2011. On the other hand, the chances of finding a permanent job were lower among those who in 2011 were working under short-term or civil law contracts than among the unemployed (36.9%).

#### SOURCES OF LABOUR MARKET DUALITY

The labour market duality is usually caused by institutional factors, particularly those related to the strictness of labour law regulations and the tax wedge, but social attitudes of workers and employers play a role in the process as well.

**Chart 2. Relation between the frequency of temporary contracts and the strictness of the labour law for temporary contracts in OECD countries in 2012**



Source: own elaboration based on OECD data.

<sup>5</sup> According to Eurostat data, in 2013, on average 27.2% of temporary workers in the EU27 countries had higher education; the percentage of higher education graduates amounted to 32.3% among workers employed under open-ended contracts.

<sup>6</sup> According to the job classification by Whelan et al. (2011).

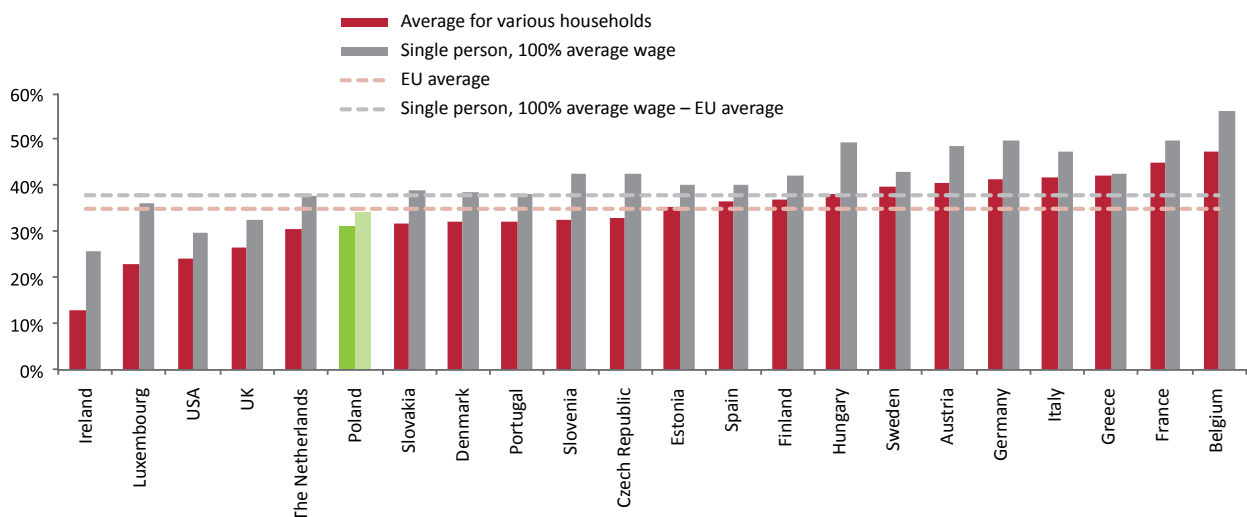
<sup>7</sup> Or an old-age pensioner or a person receiving work incapacity pension (Lewandowski and Kamińska, 2014).



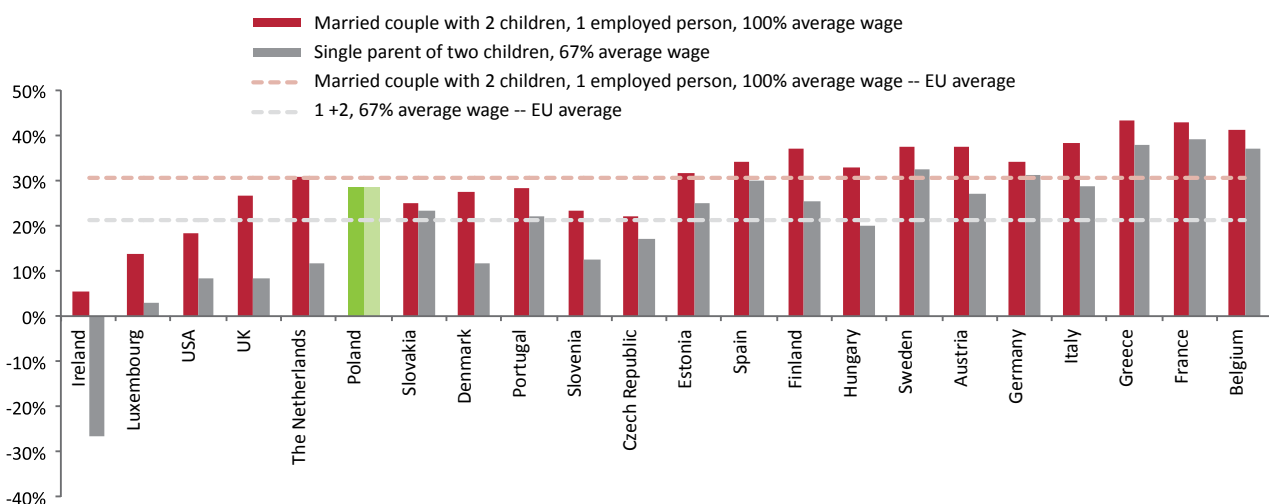
**The strictness of labour law regulations**, operationalised by the OECD as the so-called EPL (Employment Protection Legislation) index, has an impact on companies' decisions to use specific types of contracts for hiring workers. The duality phenomenon is somewhat more widespread in countries with generally more restrictive employment protection legislation, although the strictness of labour law regulations with respect to temporary contracts (fixed-term contracts and work through temporary employment agencies) is not directly correlated with the frequency of application of temporary contracts in OECD economies

– this relationship is illustrated by chart 2. There is considerable diversity in the strictness of legislation regulating temporary contracts in developed countries. In Poland, the EPL index for this category of contracts amounts to 1.75, which is one of the highest values among developed countries. Only Turkey, France and Luxembourg ensure greater protection to employees hired on a temporary basis. In terms of the share of temporary workers and the strictness of the labour law in OECD countries, Poland is most similar to Mexico and Spain (although regulations in these countries are a little less strict). Similarly strict legal restrictions

**Chart 3. Total tax wedge (total burden of income tax and social security contributions in relation to gross remuneration) – on average and for a single person earning the average wage, in selected European countries and the United States, 2011.**



**Chart 4. Total tax wedge (total burden of income tax and social security contributions in relation to gross remuneration) – for a married couple with 2 children and 1 person earning the average wage, and for a single person earning the average wage in selected European countries and the United States, 2011.**



Source: own elaboration based on OECD data.

can also be found in Greece and Estonia, but these countries have a lower percentage of individuals working under temporary contracts.

**Tax wedge**, i.e. the difference between the labour cost incurred by the employer and the net remuneration received by the worker, is another institutional factor underlying the duality. The non-wage cost of employment includes social security contributions and income taxes.<sup>8</sup> Poland has a medium tax wedge, lower than the EU average, as shown in Chart 3. In comparison to other European countries, the income tax burden of individuals earning the national average wage (or more) is rather low in Poland, particularly if such individuals have no dependants (cf. Chart 3).<sup>9</sup> The situation is different for households where one person is working and the others are dependent on that person. Chart 4 shows that the tax wedge imposed in Poland on households with two children, with one person earning 100% of the average wage, is close to the EU average and higher than in the Czech Republic, Slovakia and Slovenia. The tax wedge for low earners (individuals earning 2/3 of the average wage) and single parents is significantly higher than the EU average. Moreover, Poland is the only OECD country which imposes the same tax burden on low earners with children as on couples with children where at least one person earns the national average wage<sup>10</sup> – in other countries the tax burden on people living alone is relatively much lower.

However, Poles do not compare the taxation imposed on workers employed under employment relationship with the taxation of wages in other European countries, but rather with the taxation implied by other forms of contracting labour in Poland. Table 3 shows that replacing an employment contract with a civil law contract or self-employment increases (for the same gross wage) the worker's net income and reduces the total cost incurred by the employer.

The increase in the net pay is most significant in the case of contracts to perform a specified task (both for the

tax deductible expenses of 50% and 20%) and contracts of mandate if the worker has another social security entitlement (e.g. if the worker is a student under the age of 26 or if he has another contract which is subject to social security contributions) – in relation to an employment contract, the net income is higher by ca. 15% in the case of a social security contribution-free contract of mandate, by ca. 20% in the case of a contract to perform a specified task with tax deductible expenses of 20% and by almost 30% in the case of a contract to perform a specified task with the tax deductible expenses of 50%. In 2013, in the case of minimum wage (PLN 1600 gross) this meant an extra net income of PLN 177, PLN 235 and PLN 321, respectively, in comparison with an employment contract. From the employer's point of view, all three solutions enable saving the same amount of non-wage costs of labour, i.e. 17% of the total cost of employing a worker under an employment contract (PLN 332 for the minimum wage in 2013).<sup>11</sup> Therefore, the use of civil law contracts in lieu of employment contracts is attractive for both parties in terms of current income or costs. The readiness to accept or the willingness to achieve a higher income at the expense of lower stability and lack of social security contributions payment may be particularly high among low-paid workers.

The benefits and costs connected with replacing an employment contract with self-employment are distributed differently – due to the income-independent base for calculating social security contributions, self-employment generates a higher net income than an employment contract if the monthly revenue exceeds PLN 4600 (under the regulations from the year 2013). If social security contributions are paid by the self-employed on preferential terms, this threshold is set at the level of the minimum wage, which in 2013 amounted to PLN 1600. From the employer's point of view, the reduction in the total cost of work is the same as in the case of contribution-free civil law contracts.<sup>12</sup> The possibility to conduct business activity on preferential terms makes it easier for “genuine”

8 According to Eurostat data, non-wage costs of employment in Poland amount to 16.7% of the average cost of employment (the EU average is 23.7%). According to the calculations by PwC (2014), the taxation of work in a typical medium-sized company in Poland amounts to 26.9% of the income (the EU average is 26.6%).

9 According to the OECD data, in 2011 the average tax wedge imposed on workers earning 67% of the average wage in the EU countries amounted to 37.9%. It was highest in Belgium (50.5%) and lowest in Ireland (19.9%). In Poland it amounted to 33.3%.

10 This is related to the weakness of the Polish fiscal system – the system of reliefs is in practice available to higher earners, while the poorest earn too little to take advantage of it (Myck, Kurowska and Kundera, 2013).

11 Provided that the mandator does not pay social security contributions for the mandatary. If the contract of mandate is the only social security entitlement of the mandatary, then the employer has to pay the full amount of social security contributions and the total cost of work is the same as for an employment contract. If contributions are paid only for a part of the total income paid out to the mandatary (e.g. one of several contracts), then the amount saved by the employer is proportional to the share of contribution-free amounts in the total amount due under contracts of mandate of the given mandatary.

12 We assume that the worker is not a VAT payer, or that the employer is able to deduct VAT which is due for such a contract.

**Table 3. Net earnings of the worker, the total cost borne by the employer and the sum of income tax and social security contributions paid in Poland depending on the gross remuneration and contract type, 2013.**

Gross wage	Employment contract	Contract of mandate	Contract of mandate without contributions	Contract to perform a specified task (tax deductible expenses of 20%)	Contract to perform a specified task (tax deductible expenses of 50%)	Self-employment	Self-employment – preferential terms
Net earnings of the worker							
1 600	1 181	1 213	1 358	1 416	1 502	628	1 185
1 700	1 251	1 285	1 439	1 502	1 593	728	1 285
1 800	1 321	1 356	1 520	1 587	1 684	828	1 385
2 000	1 460	1 500	1 681	1 758	1 866	1 028	1 585
2 500	1 808	1 858	2 085	2 186	2 321	1 528	2 006
3 000	2 157	2 216	2 489	2 614	2 776	1 959	2 416
3 650	2 610	2 682	3 014	3 171	3 368	2 492	2 949
5 000	3 550	3 649	4 104	4 326	4 596	3 599	4 056
10 000	6 905	7 057	7 755	8 484	8 991	7 453	7 832
Total cost borne by the employer							
1 600	1 932	1 932	1 600	1 600	1 600	1 600	1 600
1 700	2 053	2 053	1 700	1 700	1 700	1 700	1 700
1 800	2 173	2 173	1 800	1 800	1 800	1 800	1 800
2 000	2 415	2 415	2 000	2 000	2 000	2 000	2 000
2 500	3 019	3 019	2 500	2 500	2 500	2 500	2 500
3 000	3 622	3 622	3 000	3 000	3 000	3 000	3 000
3 650	4 407	4 407	3 650	3 650	3 650	3 650	3 650
5 000	6 037	6 037	5 000	5 000	5 000	5 000	5 000
10 000	11 925	11 925	10 000	10 000	10 000	10 000	10 000
Income tax and social security contributions / total employer's cost							
1 600	39%	37%	15%	12%	6%	61%	26%
1 700	39%	37%	15%	12%	6%	57%	24%
1 800	39%	38%	16%	12%	6%	54%	23%
2 000	40%	38%	16%	12%	7%	49%	21%
2 500	40%	38%	17%	13%	7%	39%	20%
3 000	40%	39%	17%	13%	7%	35%	19%
3 650	41%	39%	17%	13%	8%	32%	19%
5 000	41%	40%	18%	13%	8%	28%	19%
10 000	42%	41%	22%	15%	10%	25%	22%

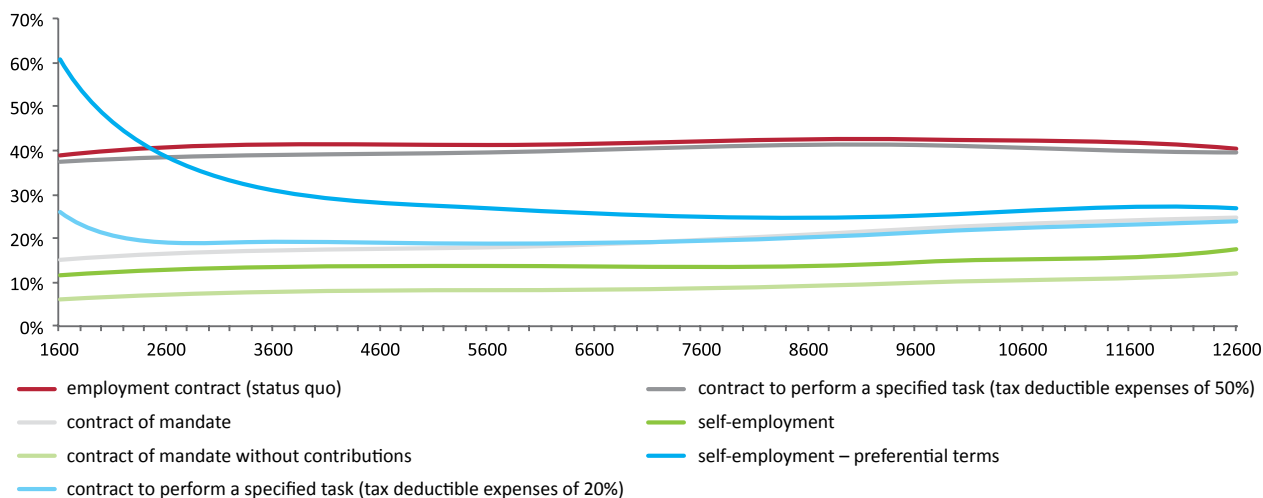
*Comments: The calculations apply to workers who settle the income tax individually and do not receive social transfers.*

*Source: own calculations.*

entrepreneurs or freelancers to start their business, but on the other hand it provides an incentive to replace employment contracts with self-employment, as it ensures immediate financial benefits to both parties.

Chart 5 shows that the total contribution and tax wedge for an employment contract in Poland amounts to ca. 40% and changes only very slightly depending on the gross remuneration. All the discussed alternative forms of contracting

Chart 5. The contribution and tax wedge in Poland depending on the gross remuneration and type of contract, 2013.



Comments: income tax and social security contributions as a percentage of the total cost borne by the employer, worker settling income tax individually and receiving no social transfers.

Source: own calculations.

work make it possible to reduce the wedge significantly, as they release both contract parties from the burden of social security contributions or at least reduce it. In Europe there are not many examples of similarly constructed relationships between widely used forms of contracting labour and the scale of levies payable to the state.<sup>13</sup>

Sentiments and habits, both those of employers and of workers, are also conducive to the emergence of labour market duality in Poland. According to the National Labour Inspectorate (PIP 2013), more and more civil law contracts are concluded in circumstances which call for concluding an employment contract instead. Since 2009, the share of contracts challenged on this account has been growing at the rate of 3 pp annually and in 2012 reached the level of 16% of all contracts which were checked in this respect. Moreover, in 2012 every sixth inspected company employed workers illegally, while 45% of employers were involved in dishonest practices of recording work time, usually understating or concealing the number of hours worked by the workers. According to the CBOS data (2013b), 86% of respondents consider worker abuse by employers to be clearly wrong and unjustifiable (with accepting bribes being the only behaviour regarded

as equally reprehensible). On the other hand, only 50% of Poles have the same stance on neglecting one's duties at work.

The common belief that the burden of public levies in Poland is excessive translates into social acceptance for bending the law and avoiding the payment of taxes and benefits. According to a survey conducted by CBOS in June 2013, 20% of Poles are clearly convinced that citizens should not pay income taxes (CBOS 2013a). Only one in three Poles thinks that tax evasion practices should be reported to the authorities. What is important, over the last decade the share of population accepting citizens' duties to the state has clearly decreased. In this climate, discussion about labour law reforms is politically difficult. An additional hindrance for enforcing the labour code rules is the low efficiency of the National Labour Inspectorate and frequent lack of cooperation and coordination between state institutions, such as the Social Insurance Institution (ZUS), National Labour Inspectorate (PIP) or law enforcement authorities.

13 One of few examples is Slovakia, where – starting from 2013 – civil law contracts have been covered with the same social security contributions as employment contracts and so far there are no reasons to believe that introducing this solution had a negative impact on the labour market and economic development.

# Policy proposals

The primary aim of this report is to suggest a package of solutions to restrict the abuse of civil law contracts and bogus self-employment in Poland, thus increasing worker security while still allowing enterprises to operate in a flexible manner. The suggested solutions go beyond the government's proposal presented in the bill on amending the Act on the Social Security System and certain other acts adopted by the Council of Ministers on 4 March 2014, which focuses on increasing the scope and the basis for imposing social security contributions on civil law contracts.<sup>14</sup> They comprise the following recommended solutions in the area of labour law and worker taxation.

## **RECOMMENDATION 1. SINGLE CONTRACT – SINGLE TYPE OF EMPLOYMENT CONTRACT**

Bearing in mind worker's social, retirement and health security, assurance of occupational health and safety, the issue of transferring copyright to end products and the employers' need for flexibility in managing labour resources, the authors propose **to introduce a single contract that would assume properties of an open-ended contract as its term progresses**. The idea has been put forward by Tito Boeri (Boeri & van Ours 2013; Boeri et al. 2013; Boeri 2011) and supported by László Andor, the EU Commissioner for Employment. Single contract is an open-ended employment contract, which provides newly employed workers with a weaker protection against dismissal than presently

enjoyed by employees working under an employment contract, yet greater than in the case of persons working under civil law contracts and self-employed individuals, and this protection increases with time. Employment protection would become equal upon the lapse of three years of employment. The original suggestion of a single contract proposed in Italy is discussed in Box 1.

Instead of a strongly polarised protection of two groups of workers – high in the case of individuals currently employed under an employment contract and low in the case of employees working under civil law contracts or bogus self-employment – the single contract ensures equal treatment of all workers with a specific length of service in a given enterprise, at the same time providing employers with greater flexibility in terminating employment with workers with a relatively short employment spell in a given enterprise than in the case of present employment contracts. Thus it reduces employers' motivation to employ workers for a fixed term, through temporary employment agencies or under civil law contracts by creating a buffer in the form of a group of workers who can be easily dismissed, which increases their human resources flexibility in adapting to the changing market conditions. At the same time, by providing workers with a short employment spell in a given enterprise with a prospect of increasing job security as the term of the employment contract progresses, it creates motivation for honest work and accumulation of experience and human capital, which is substantially better than the current solutions (particularly fixed-term contracts). Thus contracts that are easy to terminate (fixed-term, civil law contracts, and hiring workers through temporary employment agencies) would no longer be used by employers to discipline workers.

The introduction of the single contract in Poland would entail abolishing contracts of mandate and contracts to perform a specified task. In the recent report *Economic*

<sup>14</sup> According to the government's proposal, if the sum of remunerations under contracts of mandate exceeds the minimum wage (PLN 1680 in 2014), the taxable person will pay a social security contribution on that amount. For instance: currently, a worker who is employed under two contracts of mandate – for PLN 200 and PLN 3,000 a month – may pay the social security contribution only on the former one, that is PLN 42. After the amendment is enacted, the worker will have to sum the remunerations up and will pay PLN 340, since they will exceed the minimum wage. Apart from that, social security contributions will also be imposed on remunerations of individuals sitting on supervisory boards of companies registered in Poland (so far such revenue has been subject to income tax only).

### Box 1. What is *contratto unico*

The fundamental principle of the “single contract” is a compromise between the need to protect employee rights and the necessity to ensure employment flexibility and minimise the risk for employers.

The solution originally suggested in Italy, the so-called *contratto unico*, is an open-ended contract which is supposed to apply to the majority of workers,<sup>15</sup> particularly those who have low- and medium-paying jobs. Persons employed thereunder would be provided with protection against dismissal, which would be lower than in the case of persons currently employed under an employment contract, but would increase with time. The worker would acquire full rights only after being employed for three years. In the event of dismissal for economic reasons, the worker would be entitled to a severance payment, the value of which would increase by the equivalent of a five working days’ remuneration with each consecutive month of employment. With the lapse of three years, the worker employed under *contratto unico* would be subject to the existing provisions: in enterprises employing fewer than 15 workers, the severance payment would amount to six monthly salaries, while in larger ones the worker would be entitled to return to work if the labour court rules in favour of the worker.

According to the initiators, *contratto unico* permits enterprises to maintain flexibility in selecting workers in exchange for a compensation for the dismissed persons. Moreover, the prospect of expenses would encourage companies to invest in worker training – it would be less profitable to constantly employ and dismiss new temporary workers than it is now (Garibaldi & Taddei 2013).

*Contratto unico* has been criticised by different stakeholders. Employers at the EU level find the single contract an excessively restrictive solution and trade unions find the three-year period of equalisation of rights too long. Apart from Italy (in 2010), proposals to introduce the “single contract” have been presented in France (2006) and since 2010 works on single contract are being conducted in Spain.

*Survey of Poland*, OECD (2014) called for imposing full social security contributions on civil law contracts and a similar suggestion was presented by the government. However, a probable consequence of introducing this solution would be workers shifting to bogus self-employment, like in other EU states (Eichhorst et al. 2013) – elimination of such risk would require changing the principles of pursuing business activity (in order to hamper the process of shifting to bogus self-employment) or eliminating or radically reducing notice periods (in order to encourage shifting from civil law contracts to employment contracts). There is also a risk that the scale of the shadow economy and undeclared employment could grow. The introduction of the single contract makes it possible to avoid such problems and does not require changing the principles of pursuing business activity.

#### Single contract on the Polish labour market

We propose that a Polish *contratto unico* should operate as follows:

**Contract conclusion.** An employment contract could be concluded for a fixed or indefinite term. If the aggregate term of two consecutive contracts concluded with

the same employer exceeded three years, the contract would become an open-ended contract.<sup>16</sup>

**Contract termination.** The labour code would provide for three methods of terminating contracts: signing a contract termination agreement, unilateral termination with notice or termination without notice.

Contract termination by mutual agreement of the parties would be possible at any time and could specify any contract termination date. Such a termination would require a written statement from one of the parties for the other party to acknowledge. If the contract was terminated with a notice period, both parties would have to observe applicable dates. Notice periods would depend on the duration of employment of a given worker with a given employer and they would amount to:

- 2 weeks – if the worker has been employed for a term shorter than 12 months,
- 1 month – if the worker has been employed for the minimum term of 12 months,
- 2 months – if the worker has been employed for the minimum term of 36 months.

Such a structure is substantiated by the fact that the minimum notice period for open-ended contracts in Poland is currently one of the longest in the EU, particularly in the case of persons with a relatively short length of service – in the case of a three-year employment spell, the notice period is three months. In the majority of EU states, the

<sup>15</sup> Apart from specific, justified situations (i.a. typically seasonal work, substitution). However, these have to remain exceptions and need to go hand in hand with enforcing the rules (the competent Polish institution is the National Labour Inspectorate). This is because there is a risk that exceptions will be overused and the introduction of the single contract will not change anything in practice. This concern is confirmed by the fact that temporary work is currently restricted under the act to situations where the work is temporary, like substitution or seasonal work, while in practice it is applied for all types of work.

<sup>16</sup> Similar solutions were suggested by Cahuc and Kramarz, experts of the French government (Cahuc & Kramarz 2004).

notice period for persons with a three-year employment spell is one to two months (World Bank Group 2013). The reduction of notice periods, in particular for workers with an employment spell of 1 to 3 years, suggested as part of the single contract, is crucial for averaging the protection level so that it becomes easier for companies to employ persons who currently work under civil law contracts.

The notice period would commence on the day on which one of the parties reports such a wish formally, rather than at the beginning of the subsequent month or week, as is the case now. The provisions of the labour law permit shortening notice periods in specific situations, which is currently one of the greatest problems faced by employers and the major cause of actions in labour courts. After introducing the amendments, the cause of the worker's dismissal would be notified at the worker's request upon serving the termination notice.

Both the employer and the worker would be able to terminate an open-ended contract with immediate effect. However, this would be effective only if they had a justified reason. Such a reason would be a violation of rights or failure to discharge obligations by the other party (e.g. unjustified absence of the worker or delayed payment of remuneration by the employer). Each party would be entitled to appeal to the labour court in such a situation. Additionally, the contract would be terminated if the worker refused to accept the conditions of a termination amending the contract and would expire e.g. in the event of the worker's death or the employer's bankruptcy.

Filing actions with the labour court should become simplified. The time-limit for filing the action should be extended from seven to 14 or 30 days, which would provide both parties with additional time to find a lawyer and collect evidence for the hearing. The possibility to reinstate workers as an effect of the labour court decision should also be eliminated. The worker would only be entitled to receive financial compensation.<sup>17</sup> A wrongfully dismissed worker would be entitled to the maximum of a three-month remuneration for the unemployment period resulting from the dismissal.

<sup>17</sup> Pursuant to Article 45 § 1 of the Polish Labour Code, if it turns out that unilateral termination of an open-ended employment contract is unreasonable or that it violates the laws on unilateral termination of employment contracts, the labour court – in accordance with the worker's request – decides that the unilateral termination is ineffective, and if the contract has already been terminated – that the worker should be reinstated to work on the previous conditions or receive damages. However, it rarely happens that workers wish to return to their previous workplace where the atmosphere can be toxic due to the action, etc.

The amount of the severance payment in the event of dismissing the worker under the single contract – it is suggested that workers should not be entitled to any severance payment if they are dismissed due to enterprise reorganisation in the case where their employment spell does not exceed 5 years. If their employment spell is longer than 5 years, the present laws would apply, i.e. the severance payment would amount to a one-month remuneration with the employment spell of 5 to 10 years; a three-month remuneration – over 10 years, a six-month remuneration – over 15 years. This suggestion arises from the fact that, contrary to numerous European states, the major cause of problems with terminating open-ended employment contracts in Poland is the notice period rather than high severance payments (World Bank Group 2013). Polish workers are not normally entitled to any severance payments in the event of terminating the employment contract (apart from the holiday compensation) unless their dismissal arises from reasons attributable to the employer (i.a. the economic condition of the enterprise). However, in the case of relatively short employment spells, it is necessary to introduce a solution that would balance the present disproportions between workers employed under an employment contract and other workers.

**Introducing a single contract would not be tantamount to removing the possibility of concluding a fixed-term contract of employment.** Such contracts are necessary, as otherwise an employer who hires a person to perform a task with a specific deadline would have to terminate the single contract. Termination involves additional obligations, costs and complications. From this point of view, the replacement of fixed-term contracts with solely the single contract is not beneficial. What should be stressed, however, is that the current obligation – according to which contracts concluded subsequently with one employer for a term of three years should transform into an open-ended contract – would remain in force, and such contract would follow the principles of single contract, with the terms of fixed-term contracts calculated into the employment spell.

The single contract concluded by the employer with the worker would still enable the use of currently applied flexible forms of organising the place and time of employment, i.e. flexitime, shift work, telework, part-time work, etc. Trade union organisations, the government and, in particular, employer organisations should bear the burden

of promoting such solutions as mechanisms of adaptation, allowing companies to adapt to market conditions to a larger extent thanks to their internal and not external flexibility (i.e. dismissals and hires). The scale of using these forms in Poland is lower than in other EU countries (Kryńska 2009). Polish employers more often reach either for inflexible (regular employment contract) or very flexible forms of employment (civil law contracts), without looking for intermediate solutions, which may be caused by low awareness of the existence of alternatives among persons responsible for human resources management.

**Risks.** It would be possible to circumvent the labour law by hiring seemingly self-employed workers or by hiring workers through temporary work agencies – both these problems could be solved only by effective inspections performed by the National Labour Inspectorate. In particular, the Temporary Work Agencies Act should be supplemented by a list of penalties for violating its provisions, while the National Labour Inspectorate should be obliged to report any abuses to the relevant Regional Labour Office, an institution maintaining registries of agencies and awarding licences for their operation.

## **RECOMMENDATION 2. TWO LABOUR CODES: ONE FOR SMALL ENTERPRISES, ONE FOR MEDIUM-SIZED AND LARGE ENTERPRISES**

Some of the problems related to the dual labour market could also be solved by introducing fewer obligations for small employers. An increasing number of public institutions, such as the Commissioner for Civil Rights or Chancellery of the President, but also the employers' organisations notice the problem of excessive administrative burden on small enterprises. It includes, among others, the development of in-house work regulations and holiday plans, matters related to OHS, etc. On account of the direct contact with the employer, persons working in small companies do not require so many additional formal obligations. On the other hand, the existing burden may discourage employers from concluding employment contracts.

According to Fenwick, Howe, Marshall and Landau (2007), small enterprises provide a low standard of jobs on account of: financial instability, short period of market presence and work on a seemingly formal basis, i.e. evading the legal requirements. Experts from the International Labour Organisation believe that introducing separate

forms of employment for small and medium-sized companies is ineffective and results in the increase of low productivity entities. However, the proposals listed below do not involve amending the Labour Code itself, i.e. do not distinguish between the principles of employment depending on the company size. They are indirectly related to the labour code, as they refer to additional formalities which are subject to control by the National Labour Inspectorate. These are also obligations which employers see as creating additional costs.

In Poland, around 60% of workers are employed in micro-, small and medium-sized enterprises,<sup>18</sup> although in actual fact more persons work in this sector, on account of family members who assist entrepreneurs conducting business activity (Tarnawa & Zadura-Lichota 2013). The share of workers employed in the SME sector in the total number of persons employed in companies in Poland is slightly higher than the EU-28 average (69.0% in relation to 67.2%). In Poland, relatively more people (43%) are employed in companies employing under 20 persons than the EU average (39%). This is caused by self-employment and a relatively large percentage of persons working in companies with up to 10 employees – which amounts to 37% of workers in Poland and only 30% on average in the EU. However, according to Eurostat, microenterprises employing 10 to 20 employees create only 5% of jobs, whereas the EU average is 9%. The potential barrier to the further development of microenterprises are the labour law regulations concerning companies with a larger number of employees. In 2013, following the introduction of amendments enabling the lengthening of the working time settlement period, many small companies decided to use this solution. According to data of the National Labour Inspectorate, agreements on lengthening the settlement period are mainly concluded in companies employing between 50 and 249 workers – they are responsible for almost 35% of agreements concluded so far (as at March 2014). Companies employing between 10 and 49 workers came second (28%). This means that this solution was also relatively popular in companies employing around 20 workers. In companies employing over 250 employees, such agreements were concluded half so often (17%).

Based on the above-mentioned arguments, but also others that come up in research on small enterprises – see

<sup>18</sup> Microenterprise – employing up to 9 workers; small enterprise – employing between 10 and 49 workers; medium-sized enterprise – employing between 50 and 249 workers; large enterprise – employing over 250 workers.



Tarnawa & Zadura-Lichota (2013) – it is possible to formulate a conclusion that a separate labour code should apply to companies employing fewer than 20 persons. This is also the threshold to create a Company Social Security Fund. The provisions of the small enterprises labour code could include:

1. **No obligation to send employees to periodic medical examinations**, if the work is not detrimental to health or does not entail health risks, or stipulating that such examination ordered by the previous employer could be honoured by the subsequent employer, e.g. for a validity period of one year, if a person is hired to a similar position.
2. **The possibility to pay an equivalent remuneration for a working Saturday**, instead of another free day chosen in agreement with the employer.
3. **Lack of pre-retirement protection against redundancy**. At the moment employees cannot be made redundant four years prior to reaching the retirement age.
4. **Covering the cost of sick leaves only up to 14 days of the employee's absence**. After 14 days, the cost would be covered by the Polish Social Security Institution (ZUS). At the moment, the limit binding on all employers is 33 days (with regard to workers under 55). In order to minimise the cost of such solution for ZUS, which may be quite considerable, it is necessary to simultaneously introduce solutions discouraging from the abuse of such leaves, e.g. first 2 days of leave without remuneration and then payment of 80% of the salary starting from the third day.
5. **No obligation to create holiday plans**. As a rule, each employer has to work out a holiday plan which specifies dates of holiday leaves. Such a plan is created taking into account employees' applications and the need to ensure business continuity. However, the employer is not bound by employee applications if they collide with ensuring business continuity.
6. **Allowing to calculate family members' remuneration as company costs**. It is estimated that one in ten Polish enterprises is a family business. At the moment, remuneration paid to a family member employed in such a company cannot be calculated as company-related cost – as it is with an employee who is not a family member. The tax office may impose penalties on a company if the remuneration of a family member is too low and does not correspond to the value of the work. Only social security contributions for an

employed relative may be calculated as costs. The essence of the change is that all remuneration could be included in the cost.

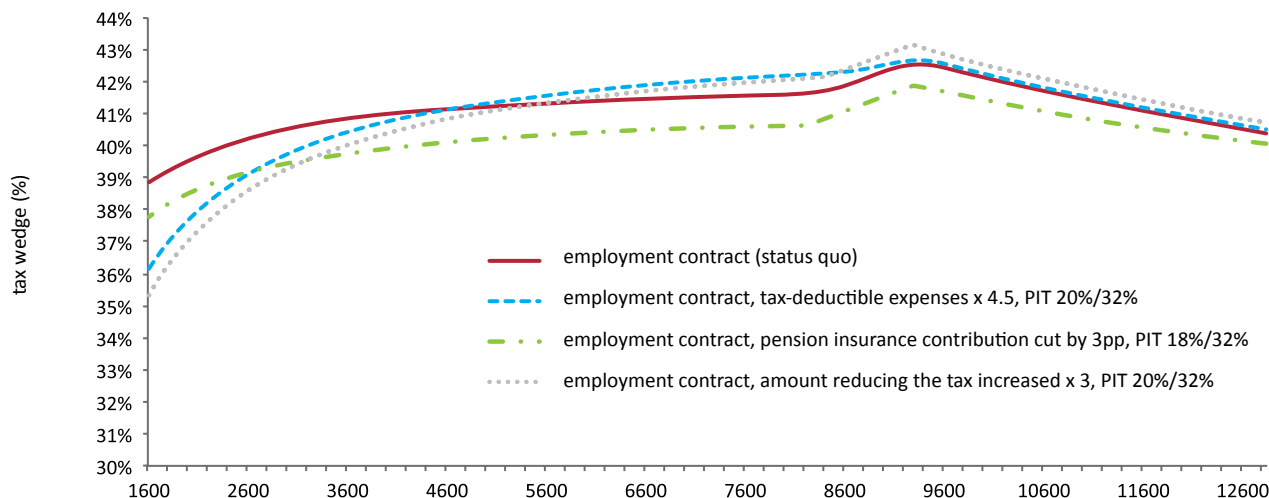
7. **A special employee delegated to OHS tasks would be required only in companies employing more than 25 workers**. At the moment, OHS tasks may be performed independently by small employers, i.e. companies employing fewer than 10 workers or up to 20 workers, if the company's business poses a low risk to the personnel's health.<sup>19</sup> However, they have to fulfil an additional obligation of passing adequate training. Following the changes, the threshold would be 20 persons, if the business activity may pose a risk to the health of staff and 25, if the activity is a low-risk one.
8. **Abolishing the obligation to retain employee files or the possibility to retain them in electronic form for all companies**. In the case of the worker's personal files, these have to be retained for 50 years after the lapse of the employment relationship, in the case of payroll documentation – 50 years starting from the date it was generated. HR documents for pension purposes should be stored by State Archives or another public institution appointed by the government rather than by a private institution. Alternatively, employers should be allowed to retain such files in electronic form, e.g. in specialised archiving companies.
9. **Popularisation of collective work agreements and company negotiations**. In the opinion of the authors, the burden of regulating contracts concluded on the labour market should be shifted from legal regulations to negotiations between the employer and the worker. The amendments of the labour law are intended to facilitate the negotiations of employment conditions using already existing legal instruments – employee councils or trade unions.

### RECOMMENDATION 3. REDUCING THE TAX BURDEN OF LOW EARNERS

The labour market duality and potential need for public intervention do not apply to all persons working under civil law contracts. In some cases, these forms of contracts reflect the nature of the work performed and result from individual choices. It can be supposed, however, that particularly in the case of simple jobs and low earners, the

<sup>19</sup> i.e. qualified to a group of business activities related to a maximum risk category of three from the regulations on social insurance for work accidents and occupational diseases.

Chart 6. The contribution and tax wedge depending on changes in the personal income tax system (for the 2013 system).



Notes: income tax and social security contributions as a percentage of the total cost borne by the employer, worker settling his/her tax individually and receiving no social transfers.

Source: own calculations.

alternative forms of contracting labour are used in situations exhibiting features of an employment relationship. According to the data of the Ministry of Finance, in 2012 the average amount of income (less the social security contributions paid) earned for services provided personally (including under contracts to perform a specified task and contracts of mandate) by individuals who derived income on this account only, amounted to PLN 30.7 thousand per year, i.e. PLN 2.25 thousand per month (in total, PLN 28.1 billion). It was, therefore, lower than the analogical amount obtained on average by workers employed under labour code contracts (ca. PLN 3.2 thousand per month).

One of the ways to decrease the incentive to replace employment contracts with alternative forms which allow smaller levies for the state, **is to reduce the tax wedge, in particular the one imposed on individuals with relatively low earnings**. The reduction of the tax wedge in line with our proposal described in the detail below, would also allow the low paid workers to derive a higher net income, and the employers to achieve lower costs of employment than is the case in the current tax system or in the case of covering contracts of mandate with all social security contributions, as suggested by the government. **The most economically effective method of achieving this goal is to raise the tax deductible expenses related to earning income from the paid work, in particular under the employment relationship**. At the same time, to ensure that the reform is addressed to persons who are potentially

affected by the labour market duality rather than to all workers, we propose to **increase the personal income tax rates in such a way that the tax burden of individuals earning above the national average stays at a level similar to the current one**, and the change does not result in decreasing the budget revenues from PIT.

Chart 6 presents a proposal for such a change – the tax deductible expenses are increased four and a half times (for the system in place in 2013 this would mean an increase to PLN 501 per month i.e. PLN 6008 per year), and the basic income tax rate is raised from 18% to 20% (the second income tax rate remains at the level of 32% and the tax brackets remain unchanged too). This translates into reducing the tax burden only for workers earning up to PLN 4 thousand gross per month (according to the 2013 level of prices and wages), with the reduction affecting mainly individuals earning below PLN 3 thousand gross, and most significantly those earning below the median of earnings from work. For the minimum wage, this means reducing the tax burden by 2.7 pp and increasing the net income by PLN 52.5 per month, i.e. PLN 630 per year. On the other hand, the proposed changes in personal income tax would slightly increase the taxation of persons earning over PLN 4.5 thousand per month, with the increase in the effective tax rate not exceeding 1 pp.

Chart 6 also shows that the proposed solution is more efficient in addressing the tax wedge reduction to persons earning relatively little than other ways of reducing the

Table 4. Total changes in the disposable income of households by income deciles and the total change in the disposable income of households (i.e. total cost for public finance) according to the proposed change in the personal income tax system, in PLN million, tax system for 2013.

Decile	1	2	3	4	5	6	7	8	9	10	Total
Households' income change	58	62	54	108	121	97	47	-14	-170	-569	-206

Source: CENEA calculations based on the SIMPL model.

tax wedge, e.g. by cutting the disability pension insurance contribution by 3 pp. Reducing the disability pension contribution results in a proportional decrease of the tax burden for all employees. If this was combined with increasing the basic income tax rate by as little as 1 pp, then individuals earning below the average wage would benefit less, and those earning above the national average wage would benefit much more than in the case of our proposal which focuses on increasing the tax deductible expenses. A similar trajectory of tax wedge change depending on gross remuneration as in the case of increasing the tax deductible expenses could also be achieved by increasing

the amount reducing the personal income tax. However, this would affect all taxpayers, which means that it would not result in relative reduction of the tax burden for individuals employed under employment contracts, while reducing the fiscal revenue. On the other hand, the proposed change, although it reduces the tax wedge imposed on low earners working under employment contracts and leads to an increase in the disposable income of the poorer half of households by the total amount of PLN 403 million (according to prices from 2013), it is practically neutral for the budget, and even increases the revenue from PIT by PLN 206 million.

# Summary

Over the last ten or fifteen years, the Polish labour market has seen a distinct increase in the incidence of temporary contracts – initially fixed-term employment contracts, then civil law contracts and individual self-employment in sectors other than agriculture (which is traditionally dominated by farms and self-employment). In 2012, among 15.6 million of workers in Poland, 4.3 million people were working under terms other than a traditional open-ended employment contract. On average, these individuals earn less than workers employed under open-ended contracts (even if other factors which influence wages are accounted for), are exposed to a higher risk of job loss and poverty and have worse promotion and skill acquisition prospects. Although in many respects their situation is better than that of the unemployed, only a small number of temporary workers is ever going to switch to stable employment.

Non-standard forms of employment can be encountered in all European countries but – particularly if we take into account their incidence – civil law contracts in Poland offer exceptionally little security to the worker, both in terms of protection against dismissal and access to social security benefits. The reasons for using these forms are rooted in institutions – labour code and labour taxation. Although the protection against dismissal of individuals hired under employment contracts in Poland is generally not very restrictive, the Polish system provides for notice periods which are among the longest in the EU, particularly in the case of individuals with a relatively short employment spell (lasting up to 2-3 years). The total taxation of income from work is not very high in terms of European standards, either, but the contribution and tax wedge imposed on individuals earning between the minimum wage and 2/3 of the average wage is considerable. What is more, for this group of individuals the major part of the tax wedge consists of social security contributions. Replacing employment contracts with civil law contracts or self-employment, i.e. forms which are subject to significantly lower social security contributions, allows the employers to simultaneously “solve” the problem of notice periods and high levies for the state, particularly in the context of tax avoidance and low effectiveness of public institutions in enforcing labour law provisions.

The proposed changes in the labour law and personal income tax have been designed to address the reasons behind the spread of civil law contracts and bogus self-employment. First of all, we propose to replace the polarised model of employment protection, which involves high protection of regular employees and low protection of other workers, with the so-called single contract, according to which the worker’s entitlements (notice period, severance payment) are much more closely related to the length of his/her employment spell at the given company than is currently the case with employment contracts. The single contract would make it easier for companies to employ workers in a flexible manner, but at the same time would offer workers a path to stable employment. Consequently, it would also introduce a better incentive mechanism encouraging honest work more than is the case currently with the vague prospect of being offered stable employment and high firing risk serving as a discipline device. Secondly, we propose to restrict some of the administrative obligations imposed on small companies, concerning such issues as sending workers for medical examinations, creating holiday plans, retaining employee files or the possibility of paying an equivalent compensation for a working Saturday. It should be emphasised that these changes do not affect the protection of workers against dismissal and do not influence their wages, but make it possible to limit other employment-related costs. Consequently, their implementation would encourage small companies to formalise and increase employment. Thirdly, we propose to increase the tax deductible expenses and the basic personal income tax rate to 20% in order to reduce the total tax burden of low earners, who are particularly exposed to the risk of employment contracts being replaced with civil law contracts. Reducing the tax wedge means higher net income for a given gross wage, or lower total cost of work borne by the employer for a given net income of the worker – in both cases the motivation to avoid paying social security contributions will be smaller. This change would bring significant benefits to lower earners and poorer households, and at the same time would not be a burden for the state budget as it is fiscally neutral.

## Annex – Civil law contracts and other forms of employment in EU

Country	Is employment other than labour code (other than self-employment) possible	Types of contracts	Contributions
<b>Austria</b>	Yes	Contracts between client and provider of service (mandate contract) Contracts for freelancers - contracts for a specific work.	Information unavailable
<b>Belgium</b>	Yes	Mandate contract Task-specific contract	Lower than in the case of employment contract
<b>Bulgaria</b>	Yes	Contract for a specific work Mandate contract	Lower contributions than in the case of employment contract: overall contributions 25.8 per cent (as compared to 30.3 per cent)
<b>Croatia</b>	Yes	Agency contract	Information unavailable
<b>Cyprus</b>	Yes	Independent contractor Independent consultant	Different contributions than in the case of employment contract
<b>Czech Republic</b>	Yes	Contract for a specific work (up to 150 hours/year) Mandate contract Contract for work outside regular employment	Contract for a specific work: no health insurance or social security contributions apply
<b>Denmark</b>	No	No other forms of employment other than self-employment and employment contracts	Mandate contract: contributions and tax rate the same as in the case of employment contract
<b>Estonia</b>	Yes	Authorisation agreements Contract for services Brokerage contract Agency contract Contract of commission	Information unavailable
<b>Finland</b>	No	No other forms of employment other than self-employment and employment contracts	Information unavailable
<b>France</b>	Yes	Task-specific contract (no separate definition; equivalent of Contract for a specific work) Mandate contract (no separate definition; agency contract is one of its forms)	Information unavailable
<b>Greece</b>	Yes	Contractor's agreements (Contract for a specific work) Agreements for independent services	Information unavailable
<b>Spain</b>	Yes	Task-specific contract, Contract for a specific work/mandate contract ( <i>contrato de servicios</i> )	Information unavailable
<b>Netherlands</b>	Yes	Contract for works (Contract for a specific work) Contract for services	Information unavailable
<b>Ireland</b>	Yes	Contract for services	Information unavailable
			Information unavailable

<b>Country</b>	<b>Is employment other than labour code (other than self-employment) possible</b>	<b>Types of contracts</b>	<b>Contributions</b>
<b>Lithuania</b>	Yes	Contract for a specific work – contract for additional work Mandate contract – applies to home-based work	Information unavailable
<b>Luxembourg</b>	Yes	Contract for a specific work	Information unavailable
<b>Latvia</b>	Information unavailable	Information unavailable	Information unavailable
<b>Malta</b>	Information unavailable	Information unavailable	Information unavailable
<b>Germany</b>	Yes	Contract for a specific work – applies to a specific group of specialists, incl. lawyers and architects No contract of mandate	Lowest contributions apply in the case of Minijobs
<b>Portugal</b>	Yes	Lump sum contract Task contract	Lower than in the case of employment contract
<b>Romania</b>	No	No other forms of employment other than employment contracts	Information unavailable
<b>Slovakia</b>	Yes	Contract for work performance Contract for work activity	Since 2013 social security contributions apply to both types of contracts, amount dependent on status of employee
<b>Slovenia</b>	Yes	Contract for a specific work Mandate contract Student-cooperative contract	Information unavailable
<b>Sweden</b>	Yes	Contract for a specific work	Information unavailable
<b>Hungary</b>	Yes	Contract for services	Lower contributions and tax rate than in the case of employment contract
<b>United Kingdom</b>	Yes	Mandate contract = agency contract	No lower contributions or tax rate
<b>Italy</b>	Yes	Project-based contracts (Contract for a specific work) Mandate contract	Information unavailable

Source: Own research; Eurostat; Eurofound; Domański Zakrzewski Palinka sp.k.;

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