

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

## SUMMARY

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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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The number of people in Poland working under contracts which do not ensure stable employment has been on the increase for several years now. The problem has become so alarming that the media, employers and trade unions started to insist that the government should counteract the spread of the so-called „junk contracts”.

**What is a “junk contract”?** There is no such category in employment statistics, and the media use it to refer to different forms of work. This term usually refers to contracts used by employers in order to circumvent the requirements of the labour law or to reduce the costs of employment. According to our definition, “junk contracts” are civil law contracts – contract of mandate and contract for result – or self-employment if they are used to formalise continuous work for one employer. A fixed-term employment contract is not a “junk contract” – although concluding such contracts for multiple-year terms is contrary to their spirit and purpose – as it involves payment of social security contributions and a certain notice period (albeit shorter than in the case of an open-ended contract).

**3.2 million Poles work under various temporary contracts.** They account for 21% of all workers, which is one of the highest rates in Europe (the EU average is 14%). This category includes both civil law contracts and fixed-term employment contracts. Another characteristic feature of the Polish labour market is the increase in the share of such contracts, which grew by 22 pp in the period 1998-2012, as compared to the average increase of 2 pp in other EU countries. According to the Ministry of Finance, 916 thousand people work solely under civil law contracts in Poland.

**The abuse of civil law contracts is a characteristic feature of the Polish labour market.** Hiring employees on conditions other than under a contract of employment is possible in almost every Member State of the European Union, but only in Poland are people hired outside the Labour Code on such a scale. In the UK, the Netherlands and some other countries the so-called “zero-hour contracts” play a similar role as civil law contracts. Slovakia used to have social security contribution-free contracts for result – ca. 300 thousand employees worked on such terms – but since 2013 they have been subject to the social security contributions at a similar level as employment contracts. Until 2003, civil law contracts were also present in the Romanian legal system. In most EU Member States, labour law regulations have been circumvented by employers through feigned self-employment.

**In Poland, the tax wedge<sup>1</sup> for a contract of employment is close to the EU average, but for a contract for result and a contract of mandate it is much lower.** In the case of people earning the minimum wage, the tax wedge for a contract of employment is 39% and 37% for a contract of commission with social security contribution paid, while for a contribution-free contract of commission the tax wedge is 15%, and for a contract for result – only 6% or 12%, depending on whether the tax deductible costs amount to 50% or 20%. In terms of current income or costs, using civil law contracts in lieu of employment contracts is attractive for both parties. The readiness to accept them or willingness to achieve a higher income at the expense of lower stability and lack of social security contribution payment is particularly high among low-paid workers.

In order to limit the prevalence of “junk contracts” and improve the situation on the labour market, we propose the following solutions:

**(1) A new type of employment contract, so-called “single contract”.** Under this type of contract, the privileges of a newly hired employee would be similar to those of workers employed under a fixed-term contract, and would increase gradually with duration of employment spell. This would reduce the employer’s risk if the new employee failed to meet their expectations. After demonstrating his/her competence and working for some time for the employer, the employee would automatically gain greater privileges under the contract. Employees with work history below five years would not be entitled to a severance payment, those working 5-10 years would be entitled to a severance payment equal to one monthly salary, 10-15 years – three monthly salaries, and over 15 years – six monthly salaries. The notice period for individuals working less than 12 months would amount to two weeks, for those working more than 12 months – one month, and those working over three years – two months. The “single contract” would entitle the employer to use flexible forms of work organisation. At the same time, introducing this type of contract would involve eliminating contracts of mandate and contracts for result. If using a civil law contract was justified by the nature of the work, the person performing such work would have to start their own business.

1 The difference between the employer’s total cost of hiring an employee under a contract of employment and the net disposable income, expressed as a percentage of the employer’s cost.

**(2) Separate labour code for small companies.** The new regulations would apply to companies employing fewer than 20 employees. The code for small companies would do away with a number of requirements which are currently a burden and generate additional costs for a large number of employers. Its provisions would include abolishing the protection against dismissal during the period of four years before the retirement age, covering the costs of sick leaves only for up to 14 days (any subsequent costs would be paid by the Social Insurance Institution, ZUS), lifting the requirement to delegate an employee for OHS tasks, lifting the requirement to retain employee files (or allowing electronic retention), or popularising the negotiation of employment terms between the employer and the employee. The single contract would ensure, however, that employees with the same number of years worked for a particular employer would enjoy the same level of protection against dismissal in all companies, regardless of their size.

**(3) Reducing the tax wedge for low earners.** One way to weaken the incentives to replace employment contracts by alternative contracts with a smaller tax wedge is to reduce the wedge for individuals who are most often employed on such terms. People working under civil law contracts earn on average ca. PLN 2,250 per month (net of social security contributions), and those working under contracts of employment earn on average ca. PLN 3200. We propose increasing the tax deductible expenses 4.5 times and raising the basic income tax rate from 18% to 20% (the second income tax rate would remain at the level of 32%). This means reducing the tax burden only for employees earning up to PLN 4 thousand gross per month and, most significantly, for individuals earning below PLN 3 thousand gross. For minimum wage earners this means a net income increase of PLN 52.5 per month, i.e. PLN 630 per year. However, the income tax revenue of the state budget would remain practically unchanged.

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