Bank Zachodni WBK
Grupa Santander

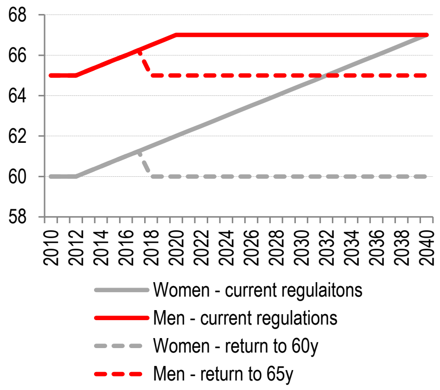
INSTANT COMMENT

21 July 2016

Lower retirement age: A step in the wrong direction

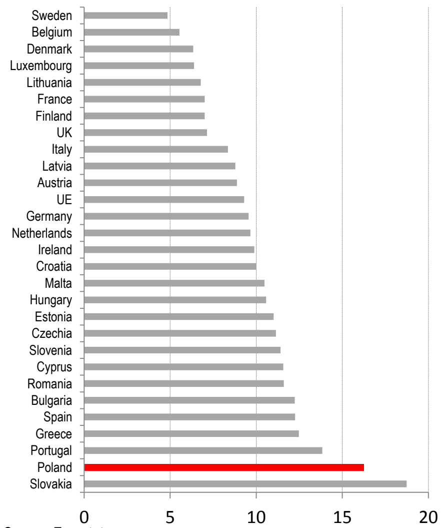
The government has backed the presidential bill lowering the retirement age to 60 years for women and 65 years for men. In our view, it is difficult to find any rational argument to support a lower retirement age in Poland, especially in its current version with no additional criteria to mitigate the negative impact (e.g. minimum number of years worked). We believe that such a solution would be negative for the economy on many levels, including: (1) high fiscal costs; (2) a lower active population (we are nearing the point where a lack of available workforce could become a major bottleneck for economic growth in Poland); and (3) lower future pensions (given the shorter period of economic activity and longer time on retirement). This decision could imply a higher path of fiscal deficit and debt and a lower path of economic growth. In our view, it could be a factor with a negative impact on Poland's sovereign rating. Obviously, we do not know the final shape of the regulation, as it could undergo changes in parliament, but the government has announced that the legislative process should be concluded before the end of this year.

Retirement age in Poland



Sources: ZUS, BZ WBK

Change in share of people aged 70+ in population in 2015-2060 (pp)



Source: Eurostat

The government backed the presidential bill, lowering retirement age to 60 years for women and 65 years for men. The government also recommended to the Sejm (lower house of parliament) to consider introducing some limitations on connecting retirement benefits with further work. According to the government representatives, October 1, 2017 is the earliest possible date the law could come into force. We would stress that the parliament will be working on this bill, so we cannot rule out that new conditions may emerge (e.g. concerning minimal working experience.)

Poland is ageing and a higher retirement age is necessary

Poland will be one of the fastest ageing countries in the European Union. According to Eurostat projections, the share of the Polish population aged 70 or over will rise by over 16 percentage points (to 26.4%) by 2060 – the second biggest rise in the whole European Union (after Slovakia). In response to the demographic changes, the previous government introduced a new regulation raising the retirement age by one month every four months, starting from 2013 (i.e. each year the retirement age increases by three months). Under the current law, the retirement age is to reach the target of 67 for men in 2020 and the same for women in 2040. At the start of 2016, the retirement age was 66 years for men and 61 for women. The changes planned by the new government would mean that Poland's retirement age for women would be the lowest in the whole European Union.

In our view, it is difficult to find a rational argument for lowering the retirement age in Poland, especially in the bill's current version, with no additional criteria that might mitigate its negative impact (e.g. minimum number of years worked). We believe such a solution would be negative for the economy on many levels, the most important being: (1) high fiscal costs; (2) a lower active population (we are nearing the point where a lack of available workforce could become a major bottleneck for economic growth in Poland); and (3) lower future pensions (given a shorter period of economic activity and longer period of retirement). We would remind readers that the earlier decision to raise the school age from six to seven years also shortened the period of economic activity in Poland.

High costs for the budget and burden for the labour market

Assuming that the retirement age is lowered to 60/65 years on January 1, 2018 (to simplify estimates) and retired people are entitled to work without losing benefits (contrary to the government's suggestions), we estimate that the number of pensioners would rise by around

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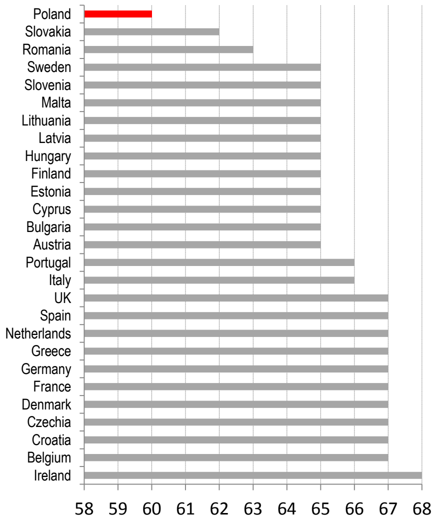
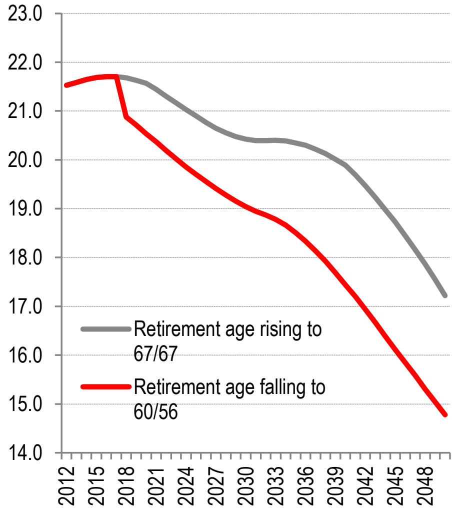
Women's retirement age (target after planned changes)



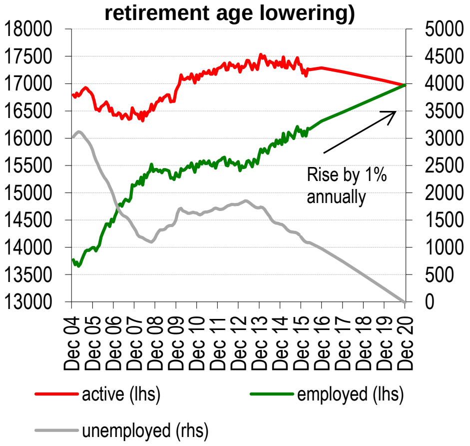
Source: BZ WBK

Population aged 24-retirement age (mn)



Source: BZ WBK

Labour market trends (no retirement age lowering)



Source: Eurostat, BZ WBK

480,000[1] in 2018 vs the baseline scenario assuming the current law with a gradually rising retirement age. For the budget, this means cPLN9.5bn of additional spending on pensions. In 2025, the number of pensioners would be c680,000 higher than in the base scenario, and the costs for the budget would hit PLN17bn. Additonally, the budget would lose revenues from the PIT and social security contributions of those people, who would become economically inactive after reaching retirement age – we estimate that they could amount to as much as 150,000 in 2018, costing the budget about PLN2bn.

Our estimates given above are based on the assumption that pensioners can still work without losing their benefits. However, if the parliament decides to introduce restrictions on the possibility of working and collecting pension benefits, some workers may decide to postpone retiring. On the other hand, older people, who have already retired but are still working, are likely to abandon their jobs (and this is not a small group – there are 80,000 workers over the age of 70 in Poland). It is difficult to estimate the net effect of such a scenario. The negative impact on the budget and the economy could be smaller – but not necessarily. It depends on how Poles react to the new regulation. For example, assuming an extreme scenario where, after the introduction of a ban on combining work with a pension, all working people reaching retirement age would keep their jobs and postpone retiring for at least a year, while all working pensioners would stop working in order not to lose their pension benefits, we estimate that the number of pensioners would rise by c270,000[2] in 2018 vs the baseline scenario (cost for the budget: PLN5.5bn) and the number of economically active people would go down by c410,000 (cost of PLN7.5bn). Thus, the total financial cost for the budget would be similar to the estimates presented earlier, but the negative impact on the labour market would be twice as strong. If we move to an even more extreme scenario, where all people choose retirement over working, the number of pensioners would rise by c480,000 (cost: PLN9.5bn) and c640,000 people would become economically inactive (cost: PLN12.0bn). Unfortunately, it is difficult to precisely estimate the possible consequences as the regulation could encourage Poles to take up jobs in the shadow economy after retiring.

Considerably lower benefits

Obviously, people who leave the labour market shortly after reaching the (reduced) retirement age would collect considerably lower pension benefits; they would pay into the system for a shorter time but would be collecting benefits for a longer time. Moreover, they may be restricted from taking up additional jobs to supplement their income so as not to lose their pension benefits. This effect would be most severe in the case of women. The previous government estimated that, in the long run, the lower retirement age (60/65) means benefits for women would be 42% lower and for men 17% lower than under current regulations.

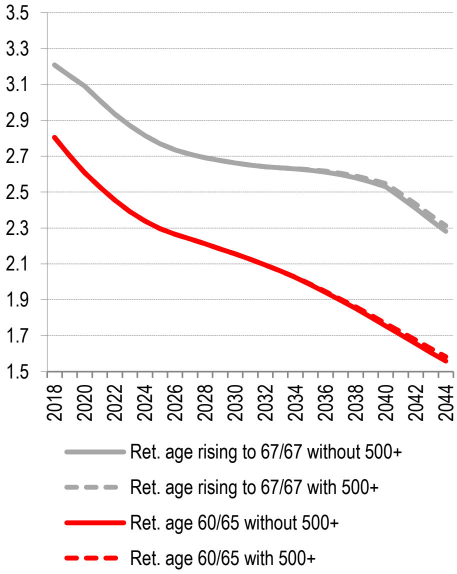
Lower potential growth of Polish economy

It is worth emphasizing that the jobs vacated by retiring people would be not easy to fill; we argue that the Polish economy is already operating at near the full employment, and employers are facing huge problems in hiring adequate new employees.

In the long run, a lower retirement age would harm Poland's economic growth potential. According to our estimates, in 2050 the population aged between 24 (i.e. after finishing higher education) and the retirement age (60/65) will total c14.8mn, compared to c17.2mn in the baseline scenario, where retirement rises gradually to 67 years. Our back-of-the-envelope estimate shows that a 15% decline in the working age population would deduct the same amount from the Polish GDP. In fact, this loss may be even higher, given the possible need to raise taxes to finance rising pension costs. Interestingly, the negative impact of demographics on the Polish labour market will probably already be felt in a couple years, as the number of economically active people will decline even without a lower retirement age, according to our estimates. In this situation, a simple simulation shows that employment rising at 1% per annum (i.e. at pace, which will allow the whole economy to grow by 3%-4%), would drive unemployment to zero by 2020 (see our *report on the outlook for 2016*). A lower retirement age means that the choke point for growth may even happen a year or two earlier. Obviously, it is not possible for unemployment to reach zero, so it is unlikely we will see employment rise by 1% –without interruption– for a couple of years; hence it is increasingly hard to imagine economic growth in Poland averaging 3%-4% over the next four years (although the inflow of people from Ukraine could act as a safety valve for the labour market in the short run).

[1] We assume that, in the scenario where retired people may work without limitations, almost everyone reaching retirement age will retire immediately.
2 We assume that only people who have no jobs upon reaching retirement age will retire.

Ratio of working age population to pension age population



Source: BZ WBK

500+ will not help much

We would like to stress that the 500+ programme, which, according to the government, should be supporting the Polish demographic outlook, is not able to revert demographic trends in Poland; what is more, it is unable to offset even a substantial part of the negative effect that the reduction in retirement age would have on the working-age population (even if we assume the most optimistic version of the programme's results expected by its authors). The margin chart on the left shows the estimated ratio between the working-age population and the retirement-age population in various scenarios: with and without a decrease of the retirement age and with/without the impact of the 500+ programme on the number of births in Poland (the government assumed that 290,000 more children would be born in 2016-26). The chart shows clearly that, until 2044 (when chidren born in 2026 will reach the age of 18), the 500+ programme has a negligible impact on the Polish labour market. And at this point of time there will already be only 1.5 working-age persons for each person of retirement age (the ratio is currently near 3:1).

Rating-negative decision

Lowering the retirement age implies a higher path of fiscal deficit and debt, and a lower path of economic growth. In our view, it is a factor that could have a negative impact on Poland's sovereign rating. Of course, we do not know what final shape the regulation will take, as it may change in the parliament. In this connection, the government stated that the legislative process should be concluded before the end of this year. If the deputies decide to introduce additional retirement criteria (e.g. minimum number of years worked), the impact of the regulation on the economy could be lessened.

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