Let's not put the future of pensions at risk

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Pensions are again at the heart of an intense debate. Adjustment for inflation and the repeal of the 2011 and 2013 reforms are among the demands that are putting the sustainability of the system, and consequently the sufficiency of future pensions, at risk.

In a constantly changing society the public pensions system needs tweaking, but the way to approach it is through rigorous and calm debate, acknowledging the advantages of the existing system of distribution, its current status, future forecasts, and available options.

First of all, we need to acknowledge the significant redistribution that the system handles. New pensioners start with an pension that they will fortunately receive for many years and is well above contributions. The contribution for retirement is 28.3% of the contribution base. With a constant demography, it would take 3 and a half years of contributions to finance one year of pension. Given a life expectancy in 2018 at age 65 of 21.3 years the system is paying pensions in excess of contributions. Before the 2011 reform, the imbalance in the system meant that each euro paid in gave a right to 1.44 euros, both sums calculated at current values. When the 2011 reform comes fully into effect, by 2027 the deficit will have fallen to 1.28 euros.

The relative generosity of the Spanish pensions system is greater than that of the majority of EU countries. For example, according to the OECD, the average starting pension in Spain is equivalent to 72.3% of final salary as opposed to 45.9% for the EU. The European Commission reveals that the average retirement pension compared to average salary in Spain (65.4%) in 2013 was the second highest in the EU, after Cyprus, and above the European average (45.5%).

These figures bring to light the significant intergenerational redistribution that the public pensions system involves. As a result, according to Eurostat, the percentage of the population over 65 at risk of relative poverty in Spain was 14.4% in 2016, almost 4 points lower than the EU average (18.2%), whilst that of the population under 65 was 6.2 points higher.

For years this generosity was financed thanks to the number of contributors growing faster than the number of pensioners, through the incorporation of the baby boom generation into the labour market, and later through the increase in immigration. The economic crisis changed this situation dramatically, with a reduction of 17% in the number of contributors. Despite this, inputs into the system only fell by 4.3%. Since 2013, 69% of lost contribution has been recovered, 2017 revenues reached a record high, and now they are 2.8% higher than at 2008 levels. Whilst revenues were going up and down, the cost of pensions continued to rise at a rate of 3.9% annually since the beginning of the crisis, and the average pension has risen by 22% in purchasing power since 2007, because new pensions are higher than those that leave the system. As a result of all this, a gap opened up between costs and revenues such that the accumulated deficit between 2011 and 2017 reached 84 billion euros. Despite the crisis, Spanish society has made a huge effort to finance the accumulated deficit, to the tune of more than €9,000 per pensioner.

Secondly, we need to prepare to face the future. The challenges are even greater than the ones we are facing now. The number of pensioners will gradually increase from the current 9.6 million to around 15 million half way through the century. Barring any changes to the system, this increase could only be covered by a rise in contributors: from the present 18.4 million to something over 27 million.

Any lack of employment until this figure is reached poses the dilemma of how to share the costs of the differential. Keeping the system unchanged, or even worse, overturning the 2011 and 2013 reforms, would necessitate greater redistribution than currently, with massive cost impositions for future generations on whose shoulders all the demographic and longevity risks would fall, with negative effects on employment and productivity. Given the European Commission forecasts (2015) for the coming decades, if social contributions were to bear the full adjustment, the cost would equate to an increase of €2,809 annually for 2017 per contributor. At the other extreme, not providing additional revenue would endanger the purchasing power of the lower pensions and would oblige pensioners to bear part of the cost of the higher new pensions coming into the system.

Society has to decide which compromise to choose, in full awareness of the costs and acknowledging that there are no short-cuts or free solutions that would avoid additional costs for future generations and governments. The 2017 deficit alone represents 15.4% of the revenue from pensions system contributions (something in excess of €1,000 per member), 15% of income and property taxes on homes and businesses, or 13.3% of indirect taxation.

Increasing employment, productivity, and, along with it, wages, is a necessary condition for the changes to impose a lesser burden on society as a whole. In addition, individual (notional) distribution accounts need to be introduced gradually, like in Sweden and other European countries. The system remains public, redistributive and progressive, but more contributory and transparent. With the right design, the new pension deficit can be corrected, bearing in mind life expectancy and the predicted evolution of income and expenditure. Rebalancing the system guarantees that pensions can retain their purchasing power throughout the pensioner's life. Finally, it's necessary to improve and safeguard the minimum pension against inflation, letting the cost fall on general taxation with the supplement plainly visible.

Where there is no problem is between sustainability and sufficiency. Sustainability is a totally necessary condition for future pensions to be adequate and respectable.

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