More spending on pensions

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The negotiation of the Spanish National Budget has restored the updating of pensions with the inflation for 2018 and 2019 and has delayed the entry into force of the Sustainability Factor (FS from its Spanish s) until 2023. Although it would be wise to be prudent and wait for the recommendations of the Toledo Pact, some media outlets and experts are talking about a waiver in practice of the 2013 reform. Apart from being in any case a legitimate decision in political terms, since it is precisely down to the representatives of society in Congress to configure a pillar as important to the welfare state as the pension system and to reduce uncertainties with the approval of the budgets, we believe that it is necessary to evaluate and make known the economic implications of these measures announced regarding pensions.

As a starting point, it is advisable to take into account the fact that, according to the Pension Revaluation Index (IRP from its Spanish s), these could only increase by a maximum of 0.25% in 2018 without the permanent contribution of additional income with which to close the existing deficit, which in 2017 came to more than €18 billion. This figure is equivalent to about €150 of the average monthly pension for retirement (€1,080.52).

What is the cost of the agreements adopted? In the first place there is the economic cost. With regard to the increase of pensions by the rate of inflation, the increases announced for 2018 come to almost €1.6 billion of additional expenses in 2018 and €3.2 billion in 2019 compared to the scenario of a rise with the IRP. To this amount we must add the improvement in widows' pensions. Therefore, we are talking about an additional €4.8 billion of spending after two years. When we accumulate this amount while taking into account the life expectancy of the generations that receive this increase, the increase in expenditure ends up being about €39 billion in terms of current actuarial value with respect to the scenario of a 0.25% rise. Even if in 2018 and 2019 this additional expense is paid with more taxes, as has been announced, going forward it is an obstacle to the attainment of financial equilibrium in the pension system. Increasing pensions by the rate of inflation permanently consolidates higher spending and means an increase in the structural deficit of the pension system, upsetting one of the core lines of the 2013 reform if no other compensatory measures are adopted.

With regard to the delay in the entry into force of the sustainability factor, it should be remembered that its objective is to correct the effects on pension expenditure of the increase in the trend of life expectancy, which means that pensions are earned over more years. The current system provides pensions higher than what has been contributions and the sustainability factor only prevents this imbalance from increasing even more due to the fact that we live longer. Its year-to-year effects are small, around half a percentage point in the retirement pensions, and lower than the annual growth we have observed in them. As the new retirement pensions represent an annual expenditure of about €5.7 billion, the accumulated savings that are lost in four years increases from about €14 million ly to about €352 million. But this growth in spending would not stop in 2023 even if the Sustainability Factor was introduced that year, because the new additions from that date would have a permanently higher FS applied, instead of the one that would have been implemented in 2019. That is, all new retirement pensions from 2023 will be approximately 2% higher due to the fact that the FS is applied four years later. Therefore, in the long term, retirement contributory pension spending will be 2% higher due to this delay. As retirement pensions - which are the only ones affected by FS - represent approximately 60% of pension expenditure, assuming that this percentage remains constant (although it will surely increase), the increase is equivalent to 1.2% more of permanent spending on pensions for all generations as from that date.

In short, the increased expense due to the revaluation by the rate of inflation (2.4%) needs to be added to the accumulated savings that are lost by delaying the FS, which is equivalent to 1.2% of higher long-term spending. Both measures weigh down fiscal adjustment when we still have a high deficit and decrease the probability of meeting the deficit target. We have a very high level of public debt over GDP, which is why it is necessary to take advantage of these years of growth to recover as soon as possible the room for manoeuvre in fiscal policy with which to face future crises and the challenge of the ageing population.

Secondly, there is the cost in terms of reputation and credibility in the implementation of the reforms. Once the start-up of the Sustainability Factor is delayed, doubts arise about whether the same thing will happen again later, with this measure or with any other similar one that may be announced for the future. Similarly, even if the IRP has only been temporarily suspended, reapplying it in the future will be more difficult, especially considering some of the existing positions in the Toledo Pact.

All told, without new compensatory measures, the recently-adopted decisions involve an increase in the structural deficit of the pension system and an increase in intergenerational redistribution, which is already one of the highest in Europe, as the European Commission has recently pointed out. In these circumstances, it is essential that the Toledo Pact reinforces the sustainability of the system with measures that allow the pension system to be more efficient and equitable. The gradual transition to a public system of individual or notional pay-as-you-go accounts, as in Sweden and other European countries, is the best option. The system would remain public, progressive and pay-as-you-go, but pensions would be calculated taking into account life expectancy and the system's ability to generate income through social contributions. Regardless of the proposed measures, in no case would it be necessary or convenient to repeal the IRP, unless the aim was to leave the pension expenditure outside of the budgetary constraint and hide its implications from public opinion. The IRP is sufficiently flexible and neutral to manage any reform of the pension system with more information and transparency.