

Breakdown in the Public Pension System: Not in the Name of Demography!

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In a Spain with full employment and less incapacity, dependence on the pension system would be less than half of what it is at present. For each dependent person there would be three contributors. Most experts say that the main threat to the stability of the pension system comes from demography. It is argued that population ageing would increase the ratio between pensioners and contributors, which would then make payment of pensions non-viable since there would not be enough working-age people to fund the rising pension pay-outs.

However, less attention is paid to the fact that Spain presently enjoys robust demographic health since a large number of contributors is concentrated in the years of adulthood and the most productive period of working life, a fact which could be taken advantage of in order to fill the “piggy bank”. Yet despite this favourable demography, the pensions reserve fund is being depleted because of the economic recession.

In this number of Perspectives Demogràfiques the extent of this demographic waste is demonstrated and the debate on pensions is taken beyond the framework of simply laying the blame on demography. First, we shall analyse the structure of the social security system, distinguishing between contributors, people receiving unemployment benefits, and pensioners in order to proceed with an exercise of simulation which will permit us to calculate what the ratio would be in a more rationalised economy.

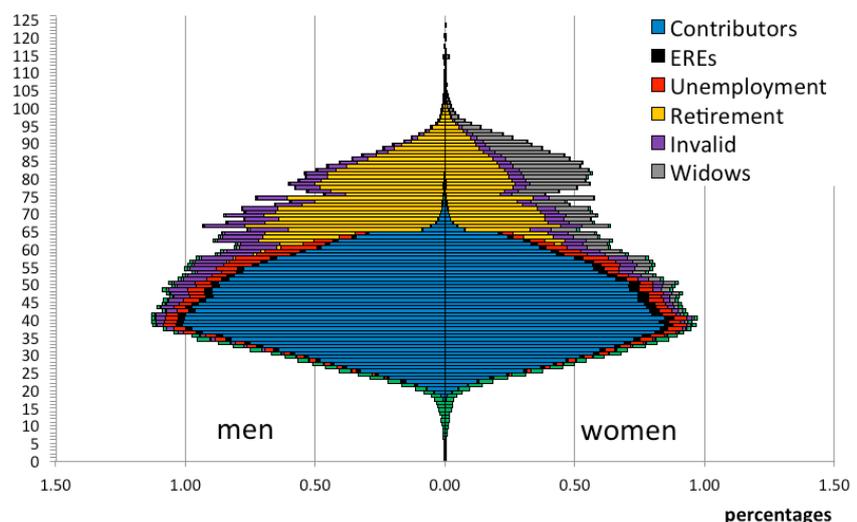
CONTRIBUTORS AND PENSIONERS: A QUESTION OF BALANCE

The public pension system in Spain today constitutes an excellent example of solidarity between generations: the cohorts which pay into the contribution system support those who receive some kind of pension.

Figure 1 shows the structure of the population linked with Social Security by age, sex and contributing situation in 2014. The whole system is sustained on the basis of net contributors, which is to say those people who make payments as part of their wages or payment obtained for their work and who, for the time being, receive nothing in return. This population grew between 2004 and 2007, after which it has been decreasing.

The time spent under a redundancy plan (ERE), where a salary is paid in part together with a partial payment of unemployment benefits, is outlined around the demographic structure of contributions. This represents a small population which has

FIGURE 1. Demographic structure of the population in Social Security according to situation, Spain, 2014



Source: Compiled by authors on the basis of the Muestra Continua de Vidas Laborales (Continuous Working Life Sample), 2014 (Seguridad Social)

Note: This has been calculated in an exhaustive and exclusive way so that all individuals are found in one, and only one situation, giving priority to contribution on receiving a pension and, in this latter case, highlighting retirement.

remained constant. In the expectation that a solution will be found for their situation, they are not considered here as either contributors or dependents. Situated in the pyramid next to this population are those who are paid an allowance or unemployment benefits. In theory, individuals being paid unemployment benefits are contributors but, in fact, it is Social Security itself which comes up with the applicable contribution. Strictly speaking, this is a dependent population.

On the threshold indicating the change from taxpayer to pensioner we have not only retirement but also invalid pensions and widows' pensions, among others. As the law stipulates, the retirement pension starts at 61 years of age and is practically universal by 65, these being, respectively, the minimum and legal ages for receiving a pension. We also see the marked gender imbalance in this area since a considerable proportion of women have devoted their potentially active working lives to family care, work that is outside the contributing sphere and which does not entail the right to a retirement pension. By way of compensation there is a widows' pension which is almost exclusively paid to the female population (Figure 1). The invalid pension requires separate study owing to the relative youth of the population concerned since it starts to be significant before the age of 40. Its marked presence in the pyramid suggests that occupational health in Spain is showing clear signs of anaemia.

This pyramid is not one of an aging population. The ages with most population range from 38 to 59. These are adults born in the 1960s and 1970s and comprising the baby boom generations, the most numerous in the recent history of Spain. This voluminous cohort presents a high level of education and was fruit of increased fertility and an incipient welfare state which distributed more and more resources. The baby boomers are at the height of their productive and, supposedly, contributing potential since, at these ages, their members should be well-placed, professionally speaking. Moreover, they still have between one and three decades of working life ahead. Yet some are being paid unemployment benefits.

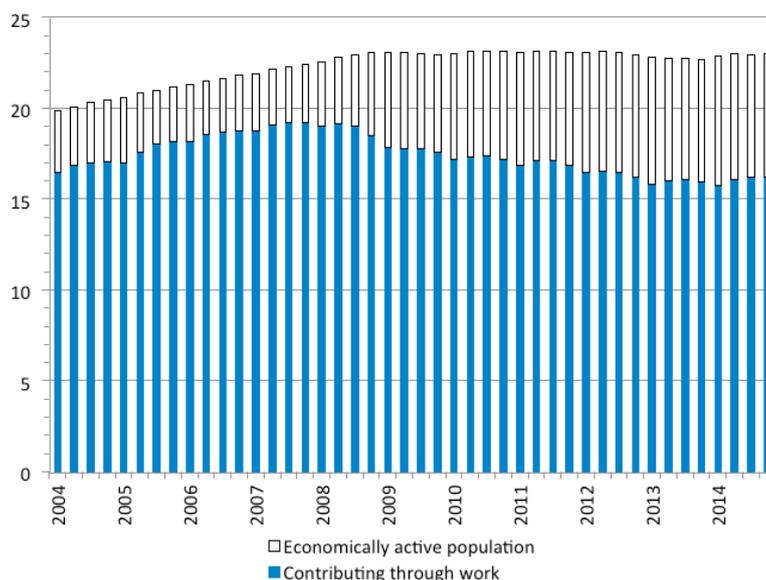
Predicting the immediate future is not complicated since the most striking figures, both entering and leaving, were already in the pyramid for 2014 (Figure 1). Hence, the generations that are now reaching adulthood are those born between 1997 and 2008 and were the result of a small baby boom during the period of economic growth. Accordingly, increasingly numerous cohorts are now joining the job market. Are we going to waste this demographic dividend?

MISSED OPPORTUNITIES: WORKERS ARE NOT LACKING BUT WORK IS

Never before has there been such a large population ready to work. However, a considerable part of it will involuntarily remain outside the formal job market and, consequently, Social Security. If we compare the net population of contributors with the economically active population (consisting of those who have jobs plus those who are looking for work) we can discover how the country is benefitting from the demographic potential (Figure 2). The workforce in Spain went from 20 million in 2004 to 23 million in 2008 and has stabilised at this level for the time being. It has not shown any symptoms of diminishing.

In contrast, the number of members of the workforce who contribute through their work has enjoyed a period of upsurge and then one of decline. Neither of these two phases has been caused by demography but, rather, by the circumstances of the job market. In the boom period they went from 16.5 million to over 19 million between the

FIGURE 2. Economically active and contributing population (millions of people): the demographic potential in Spain, 2004-2014, by quarter



Source: Compiled by authors on the basis of the MCVL - Muestra Continua de Vidas Laborales (Seguridad Social - Continuous Working Life Sample) and the EPA - Encuesta de Población Activa (INE - Labour Force Survey)

second quarter of 2007 and the third quarter of 2008. In a period of five years, two and a half million more workers joined the ranks of contributors filling the coffers of Social Security. This was despite the fact that the generations born in the late 1980s and early 1990s, "the millennials", fruit of one of the lowest fertility rates in the world, were turning sixteen, the minimum age for joining the workforce



and thus being able to contribute to Social Security. What a paradox! By contrast, in the downturn phase, the number of contributors plummeted to below 16 million so that the subsequent five-year period lost more contributors than the previous lustrum had gained.

The proportion between the contributing and economically active populations helps to estimate the wasted demographic potential. During the bonanza years, this indicator rose to more than 85% while, at present, it is just over 70%, a large drop of 15 percentage points. If the indicator for the good times is taken as a reference, we estimate that, today, 82% of the demographic potential is being taken advantage of (70 points out of a maximum of 85) and that, accordingly, 18% is being wasted. In other words, at present, the unused demographic potential involves almost one in five economically active people. In brief, the intergenerational transfusion comprised by the public pension system is holding out, even with a deficit of contributors, and this shortfall is the result not of demography but of a job offer that has, moreover, become increasingly informal. There are four million people who could contribute but who do not do so, and not for lack of desire—we would venture—but because they have not been able to find a place in an economy that nourishes the Social Security system.

TENSIONS IN THE PUBLIC PENSION SYSTEM

The population receiving a retirement pension has risen from 4.5 to 5.6 million people between 2004 and 2014, a substantial increase of 23%.

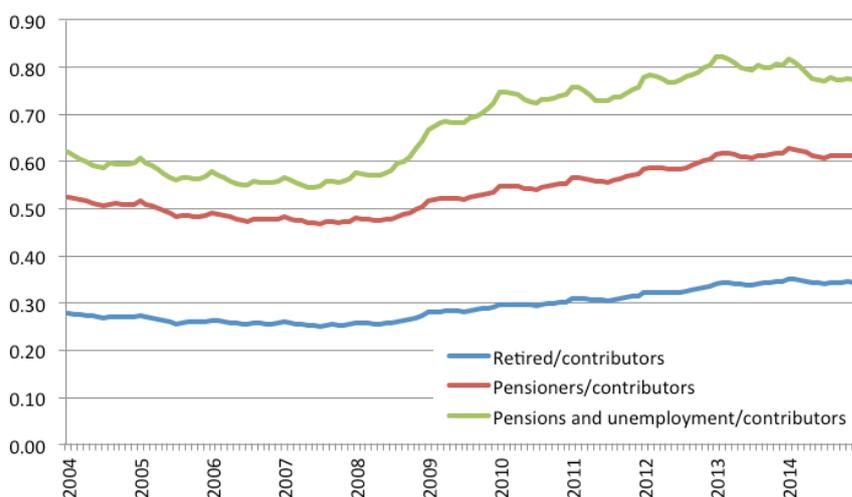
From the demographic standpoint, this volume will keep growing, not only because people are living longer but also because the generations reaching ordinary retirement age are ever more numerous and will peak in the decade of the 2040s, when the cohorts born in 1976 apply for their pensions.

Moreover, the people who are maintaining the retirement pensions of the older population are the net contributors. The flagrant waste of demographic potential demonstrates that birth-rate solutions will not help at all if the job market cannot completely absorb the available human capital. If we are to assess the magnitude of the problem today, we need to gauge the demographic dependency ratio within the Social Security system, as it presently appears.

After 2004 and until the end of the period of economic growth there was an improvement in the demographic dependency ratio between contributions and retirements, from 0.28 to 0.25 (Figure 3). In other words, the proportion went from 7 retired people for every 25 contributors to a ratio of 1 to 4. The Social Security system was thriving in terms of its relationship between contributions and retirements as the prospects for constant increase in its coffers couldn't have been more promising. In this regard, the situation at the end of 2014 is worse, although still a long way from being dramatic since, at present, each retirement pension is sustained by three contributors.

The outlook becomes increasingly gloomier when the other groups of the population who receive contributory pensions and benefits

FIGURE 3. Demographic dependency ratio in the Social Security system, Spain 2004-2014, by month



Source: Compiled by authors on the basis of the MCVL, 2004-14 (Seguridad Social).

are added to the picture. In effect, there are other kinds of contributory pension which exert pressure on the system, namely benefits paid to invalids, widows, orphans and relatives. Between 2004 and 2014, the population of pensioners rose from 8.6 to 10 million people, an increase of 16% in eleven years, which could very well be the cause of the perception of breakdown in the Social Security contributory system since, when all kinds of pensioners are added into the equation of beneficiaries over contributors, the situation turns out to be extremely complicated. While, between 2004 and 2008, the indicator improved from 0.52 to 0.48, which means a drop from 13 to 12 pensioners for every 25 contributors, in the subsequent years the dependency ratio kept getting increasingly convoluted until 2014, when the value had risen to 0.63. In other words, the ratio is



higher than 1 pensioner for every 2 net contributors or, more specifically, 16 pensioners for every 25 contributors.

The pressure on the system becomes unsustainable when the people receiving unemployment benefits are added to the pensioner population because the demographic dependency ratio in the Social Security system then reaches a ratio of 0.8 which means that, for every 5 contributors, 4 people are receiving a pension or unemployment benefits. It has not always been thus, since the ratio improved slightly between 2004 and 2007, from 0.6 to 0.56 or, in other words, with 15 dependents for every 25 contributors the ratio went to 14:25.

How can this pressure be effectively relieved? As long as the job market in Spain is not able to make the most of the available human capital, an increased birth rate or immigration will only lead to greater waste of the demographic potential. Raising the legal retirement age is a very insufficient response since it has no effect on the other kinds of pensions and benefits that are not directly related with retirement from working life, for example invalid or widows' pensions.

If the full demographic potential were taken advantage of, the dependency relationship would improve by ten percentage points. If the working-age population were wholly incorporated into the formal job market, the number of contributors to the Social Security system would rise by almost twenty percentage points, and the number of people receiving unemployment benefits would drop to zero. If, moreover, occupational health were to improve to such an extent that invalid pensions became a residual category, this indicator could fall a further nine percentage points so that the dependency ratio would be half that which is affecting our society today.

Then, perhaps, the project of sustaining the public pension system would have a promising future. But, for the time being, it is under pressure.

LET US NOT BLAME DEMOGRAPHY

Intergenerational exchanges and exchanges between generations constitute one of the pillars of the welfare state. Although unemployment benefits and the pension system are, in theory, linked with and limited by individual contributions, the fact is that this is a powerful factor for social agglutination because of the help it provides for those members of the population who are unable to find work after losing their jobs, whose health situation does not allow them to keep working, and those who retire from the job market to make way for younger generations so that they can escape unemployment. To judge from the experiences of other countries, the privatisation system, whether partial or almost total, would not seem to be a good way of easing the pressure on the system. Indeed, it is more likely to wreck it.

The pressures on the Social Security contributory system are not caused at present, and neither will they be caused in the coming decades, by any strictly demographic situation. They are entirely the result of the recessive phase of the capitalist economic cycle. In order to cope with the situation, the system has created an emergency fund to be topped up in times of economic growth and drawn upon in times of crisis. For the moment, it is serving its purpose. It is necessary to think about how to strengthen the system and not how to benefit from its collapse while blaming demography for it.

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