

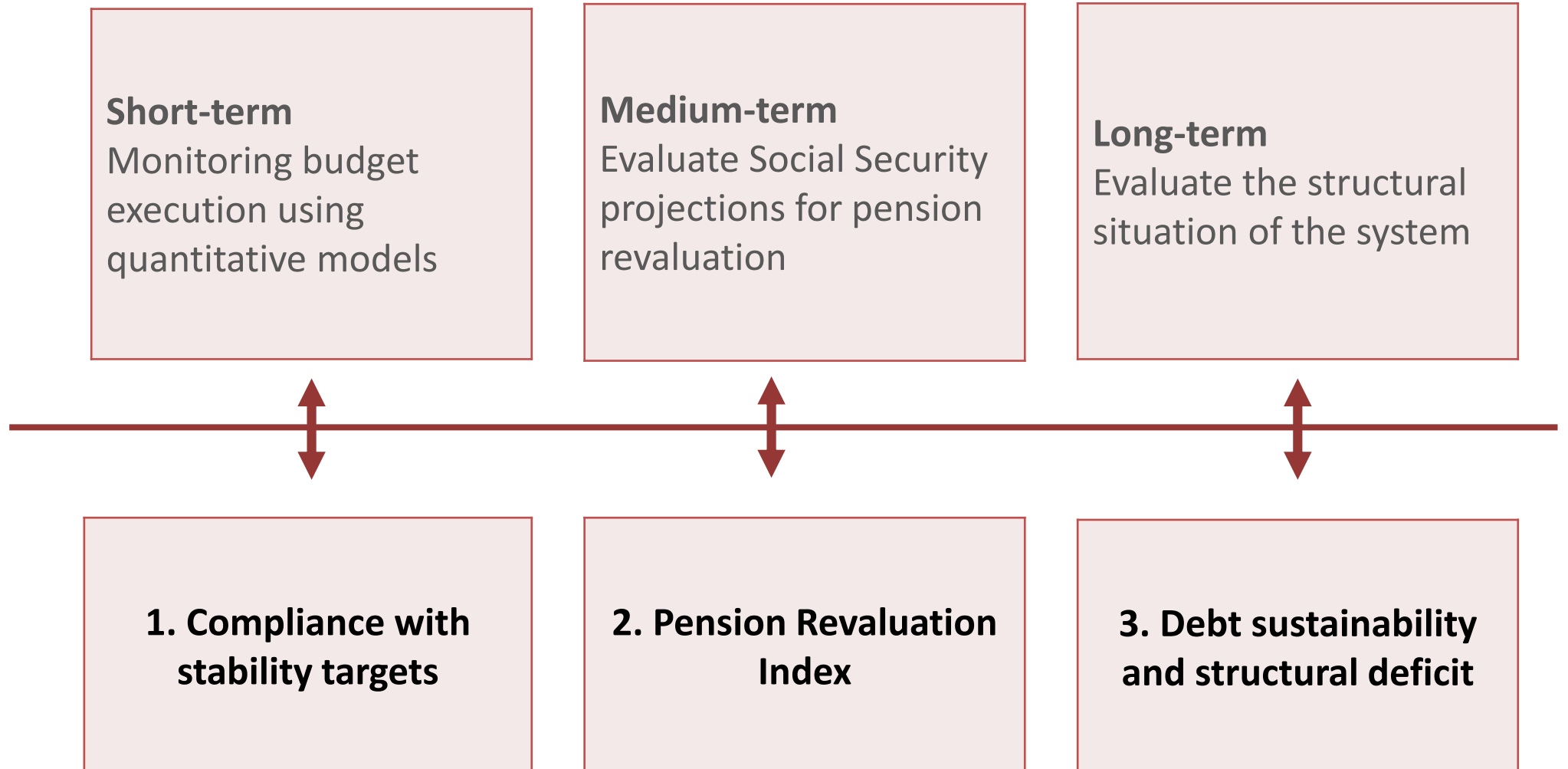


Opinion on the sustainability of the Social Security System

9 January

1. Motivation

What are AReF's pension responsibilities?



1. Motivation

2. Structural deficit and short-term proposals

3. Long-term challenges

4. Long-term proposals & conclusions



The AIReF has published in January 2019 an Opinion on the sustainability of Social Security, addressed to the Government

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2. Structural deficit and short-term proposals

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4. Long-term proposals & conclusions

Short-term

Challenge

SS deficit of 1.4 GDP points

Proposal

That the SS deficit be closed completely through adjustments of revenues and expenditures between subsectors and be viewed as a deficit of the CA

Long-term

Challenge

Ageing that puts upward pressure on pension spending by 2 to 4 points until 2050

Proposal

Deepening the 2011 parametric reforms of the pension system

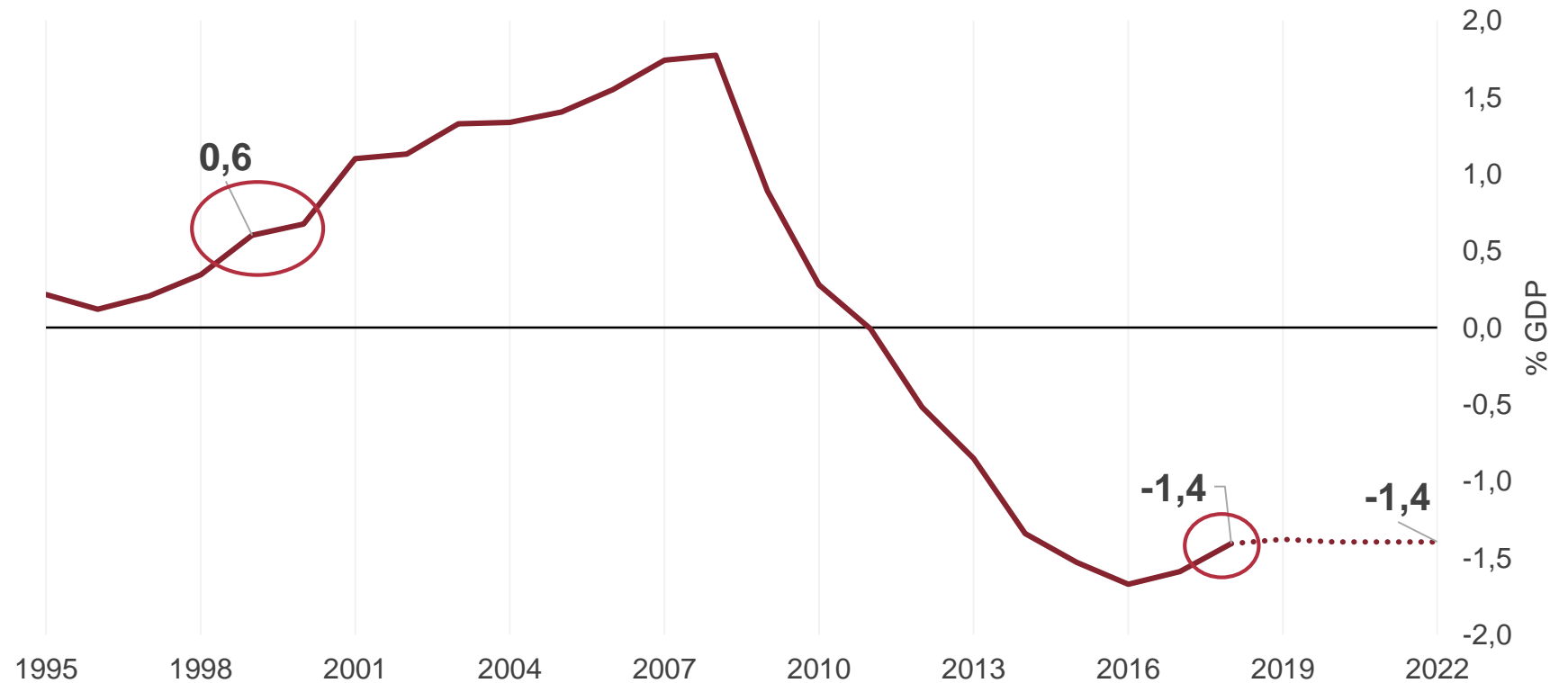
Reduction of uncertainty



2. Structural deficit and short-term proposals

Since the beginning of the economic cycle that began in 1999, Social Security has moved from a surplus of 0.6% to a deficit of 1.4% in 2018...

Net lending/ borrowing of the social security system (% of GDP)



Source: Ministry of Employment, Migration and Social Security budget execution data and estimates

3. Long-term challenges

The evolution of pension expenditure depends on interacting demographic, labour market and institutional factors

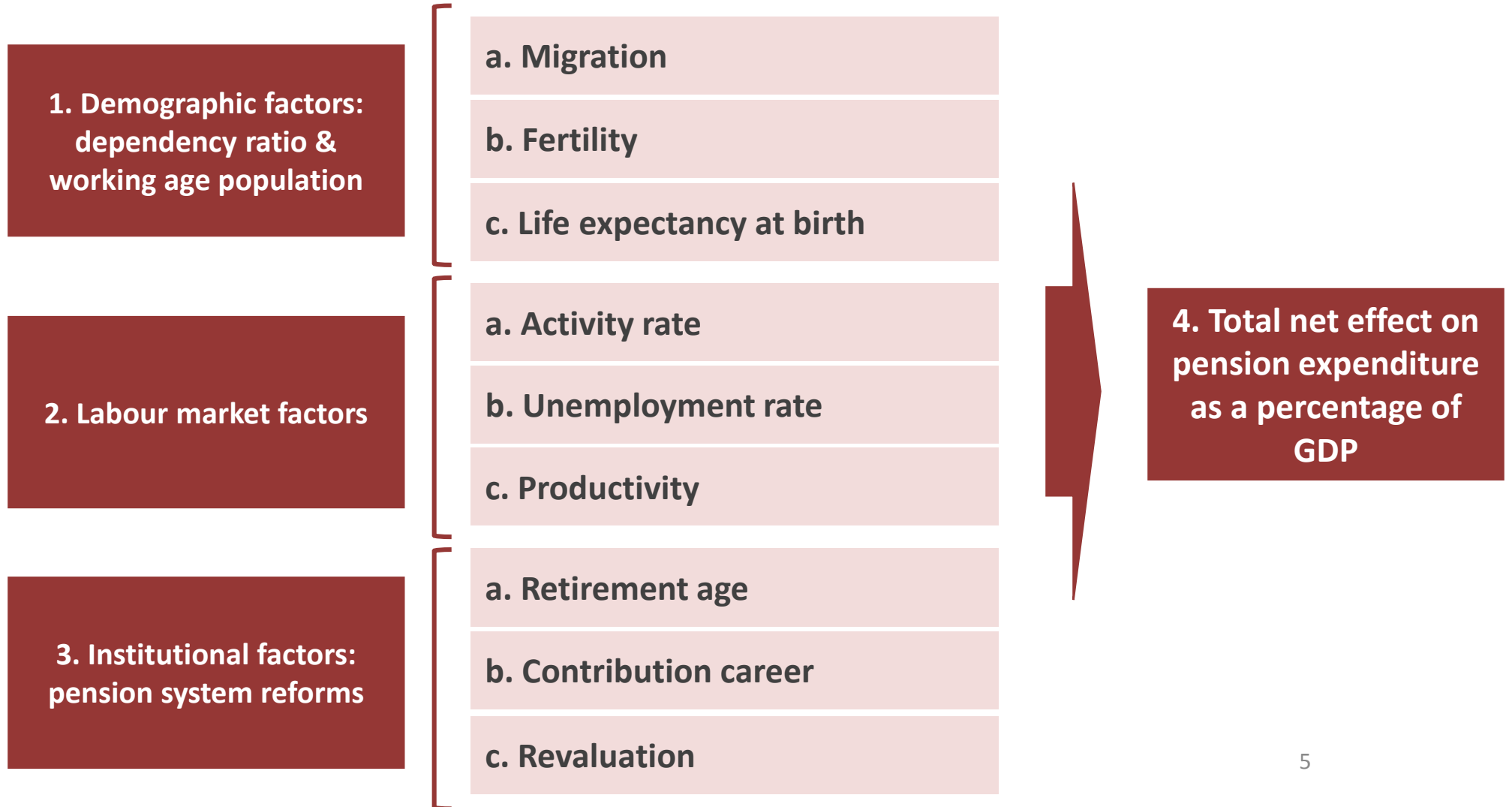
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3. Long-term challenges

- Demographic factors
- Labour market factors
- Institutional factors
- Total net effect

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3. Long-term challenges

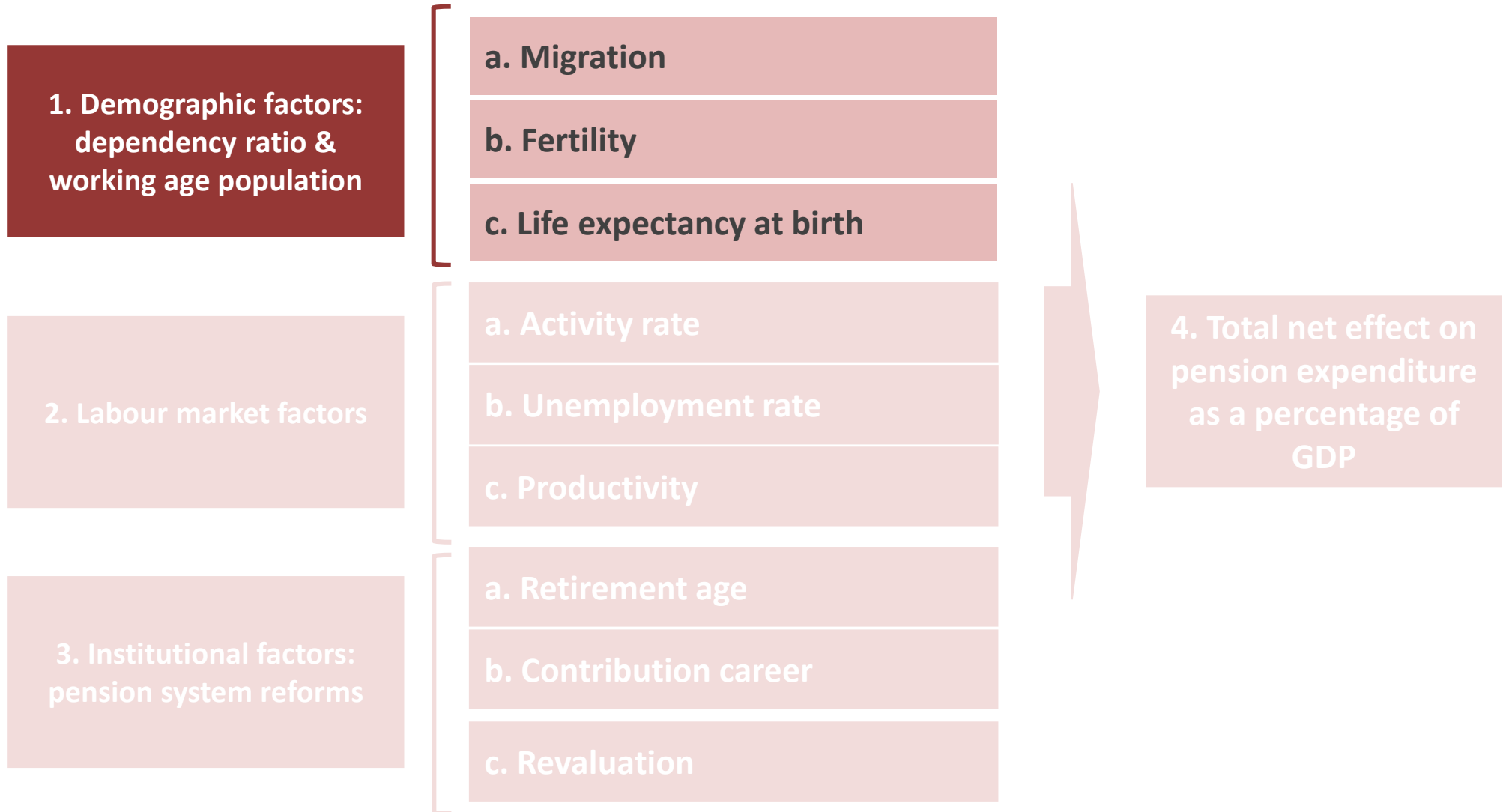
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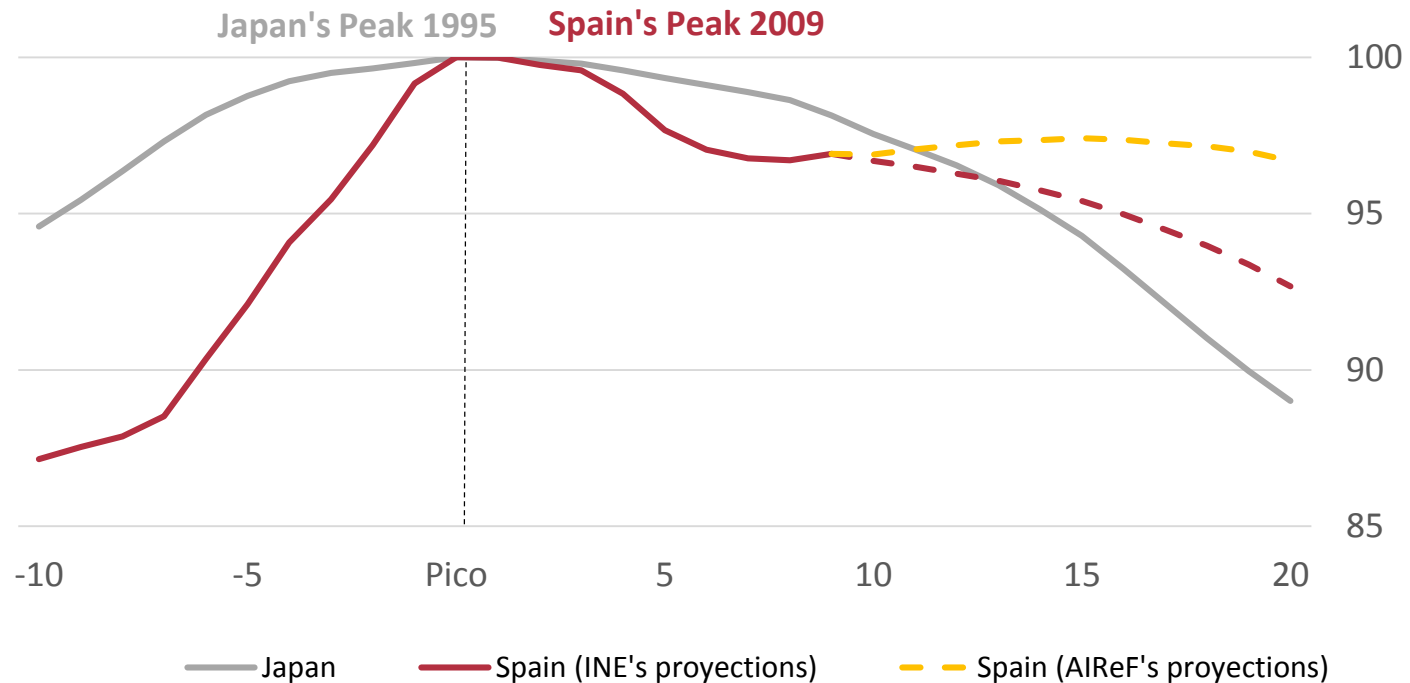
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3.1. Demographic factors

Does Spain run the risk of falling into a japonization scenario?

Working age population (100 = Peak year value)



INE's previous projections implied a steep fall in the working-age population (japonization scenario)

The implicit assumption of passive acceptance of the demographic challenge has forced AIReF to make its own projections



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What is happening in Japan?

The percentage of older people who commit crimes in order to go to prison and have their basic needs covered has risen from 2% to 20% in just 30 years

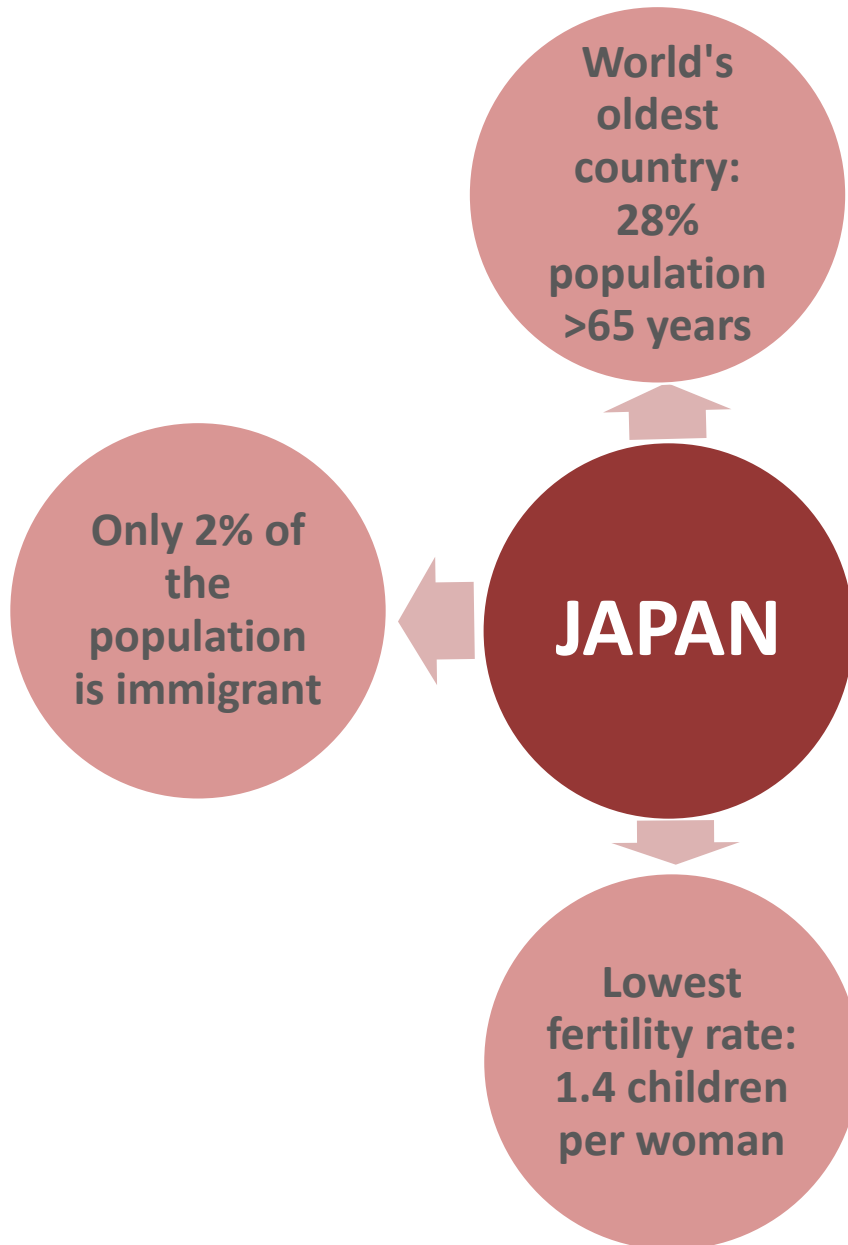


Japón se abre por fin a la inmigración: "Sin ellos estamos destinados a la desaparición"

JAVIER ESPINOSA | Hamamatsu (Japón) 23 MAR. 2019 | 02:26



Source: Ministry of Justice of Japan. El Mundo



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2. Structural deficit and short-term proposals

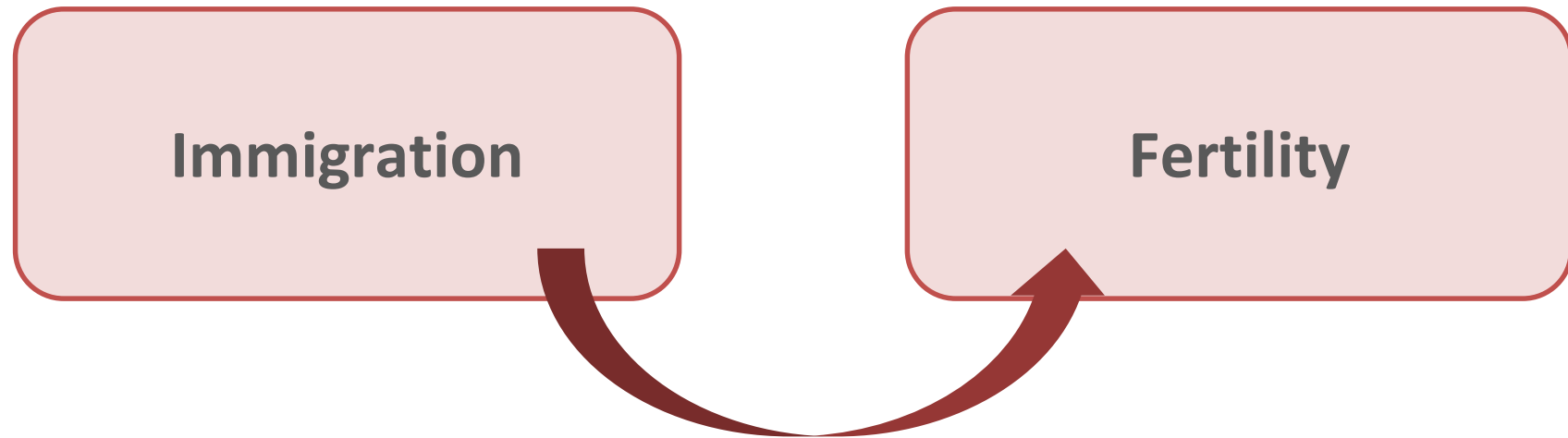
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AIReF forecasts that Spain will follow a similar behaviour to that of the surrounding countries and that the population will grow thanks to endogenous factors



Improving fertility is an important factor but not enough at all: immigration is the decisive factor in ensuring population growth

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A. Immigration. Average annual net inflow in the period 2018-2048: [220,000-320,000] persons

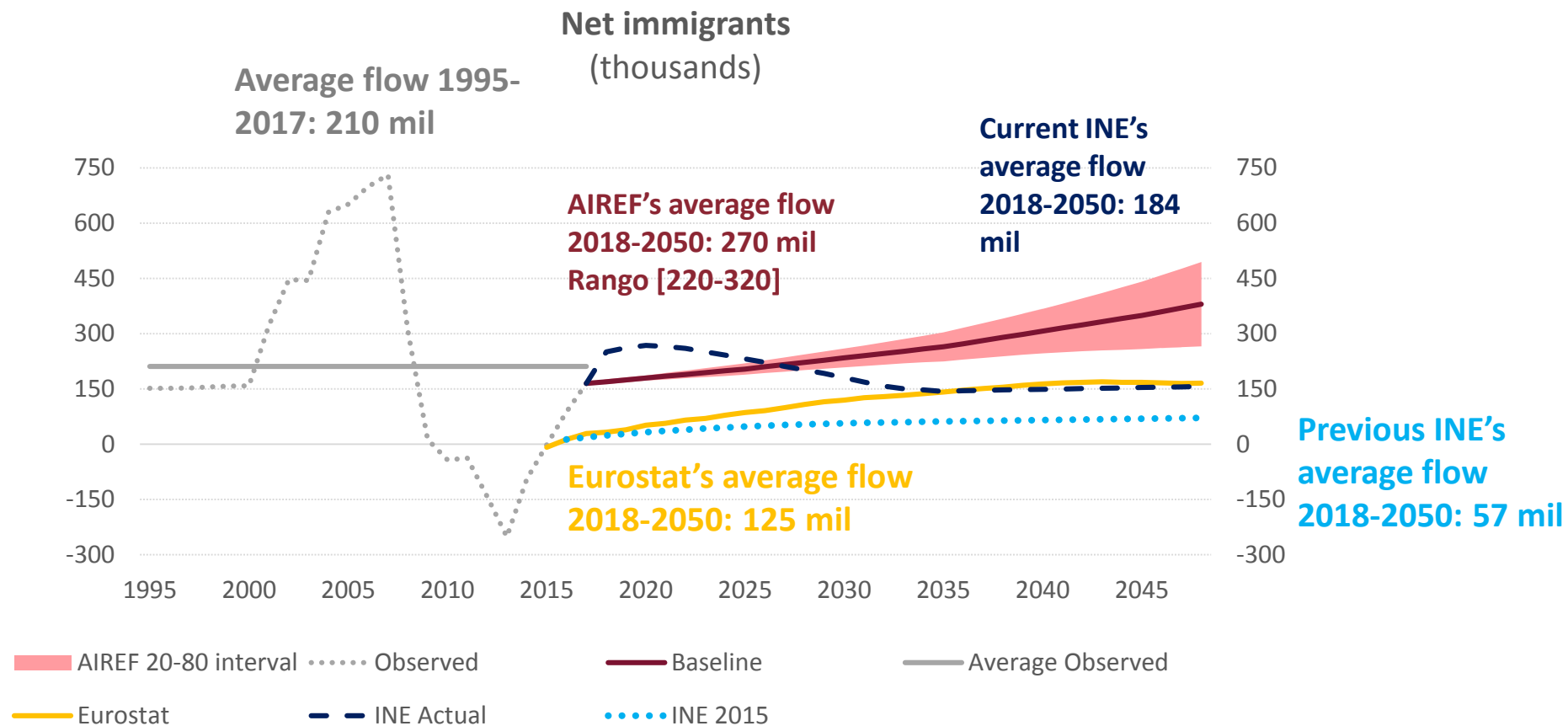
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B. Fertility. The AIReF foresees a convergence to a range between 1.8 and 2 children per woman in 2048, similar to that of neighbouring countries

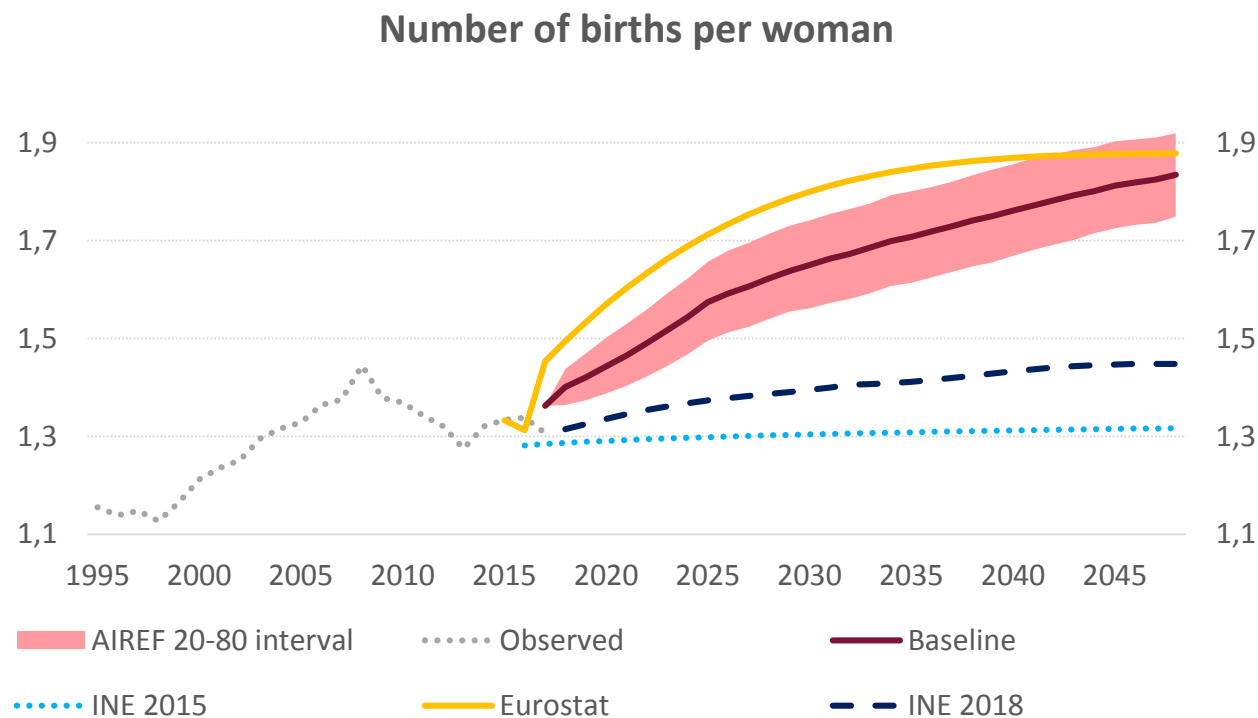
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- Spain's fertility rate is among the lowest in developed countries.
- Recent fall is due to short-term factors: precarious employment, difficulty in accessing housing, less creation of homes

C. Life expectancy. AIReF forecasts an increase in life expectancy to 87 years

1. Motivation

2. Structural deficit and short-term proposals

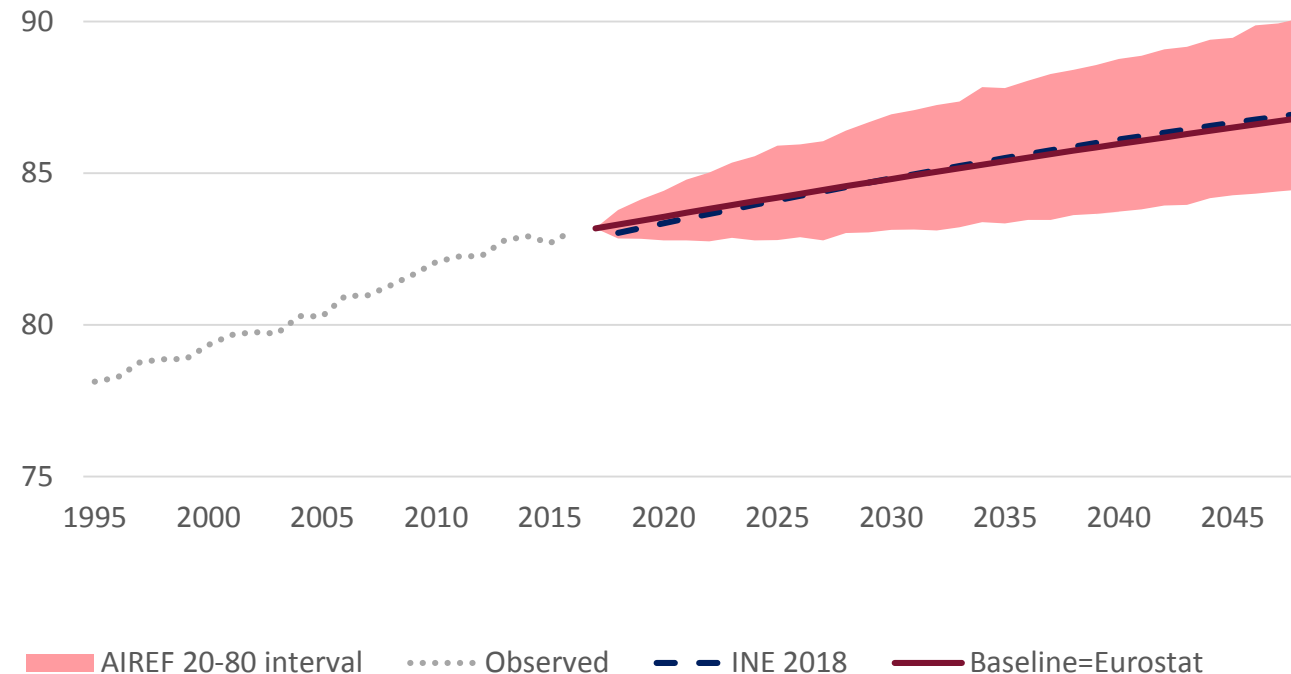
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Life expectancy at birth



Immigration is the main determinant to avoid Japonization...

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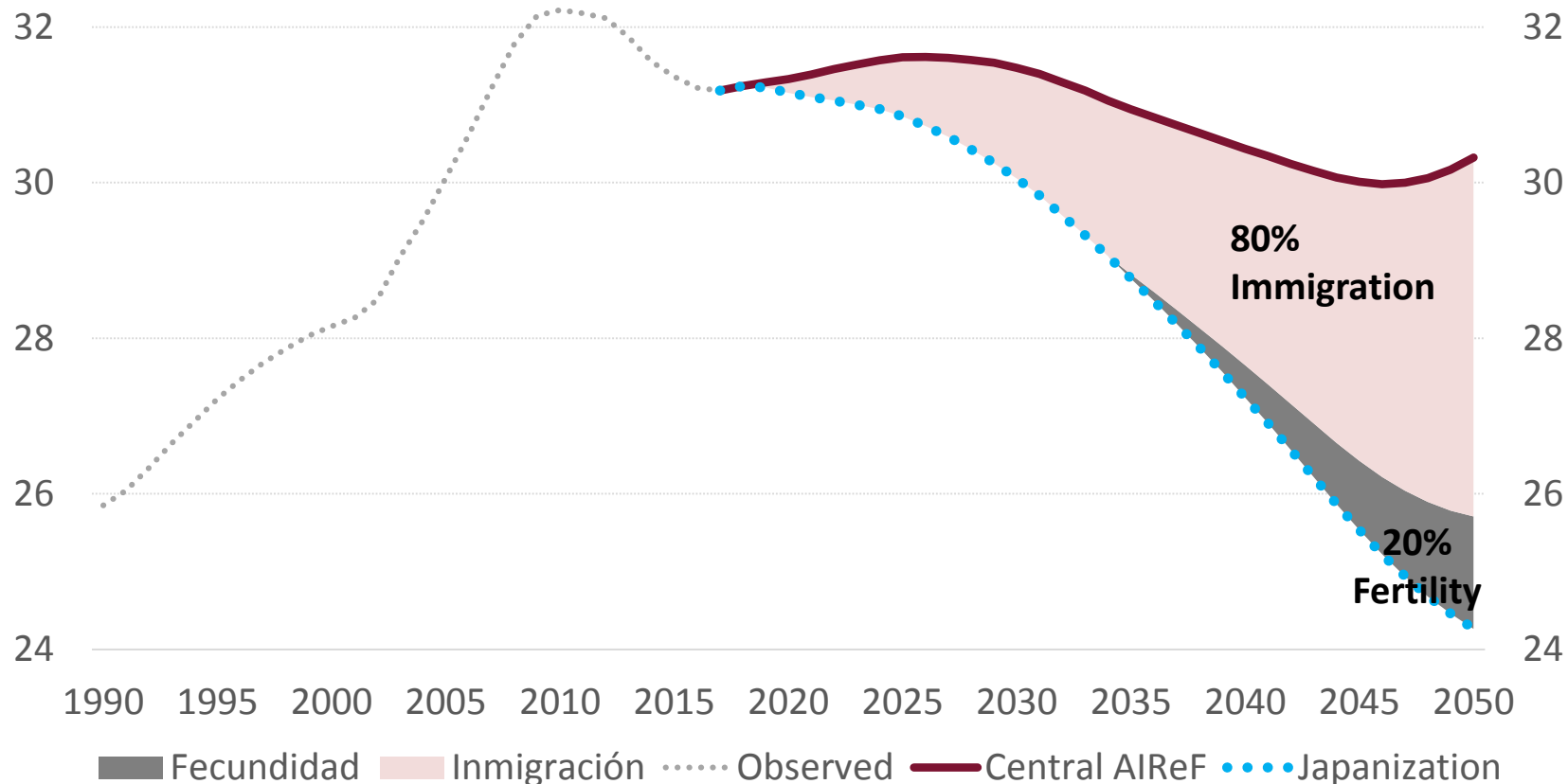
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Working age population (millions of people)



Source: AIReF's estimations, INE

Nota: The japonization scenario is defined by a simple prolongation of the last observations: net migratory flows (50,000 per year) and fertility (1.3 children per woman)



... although the dependency ratio is expected to double...

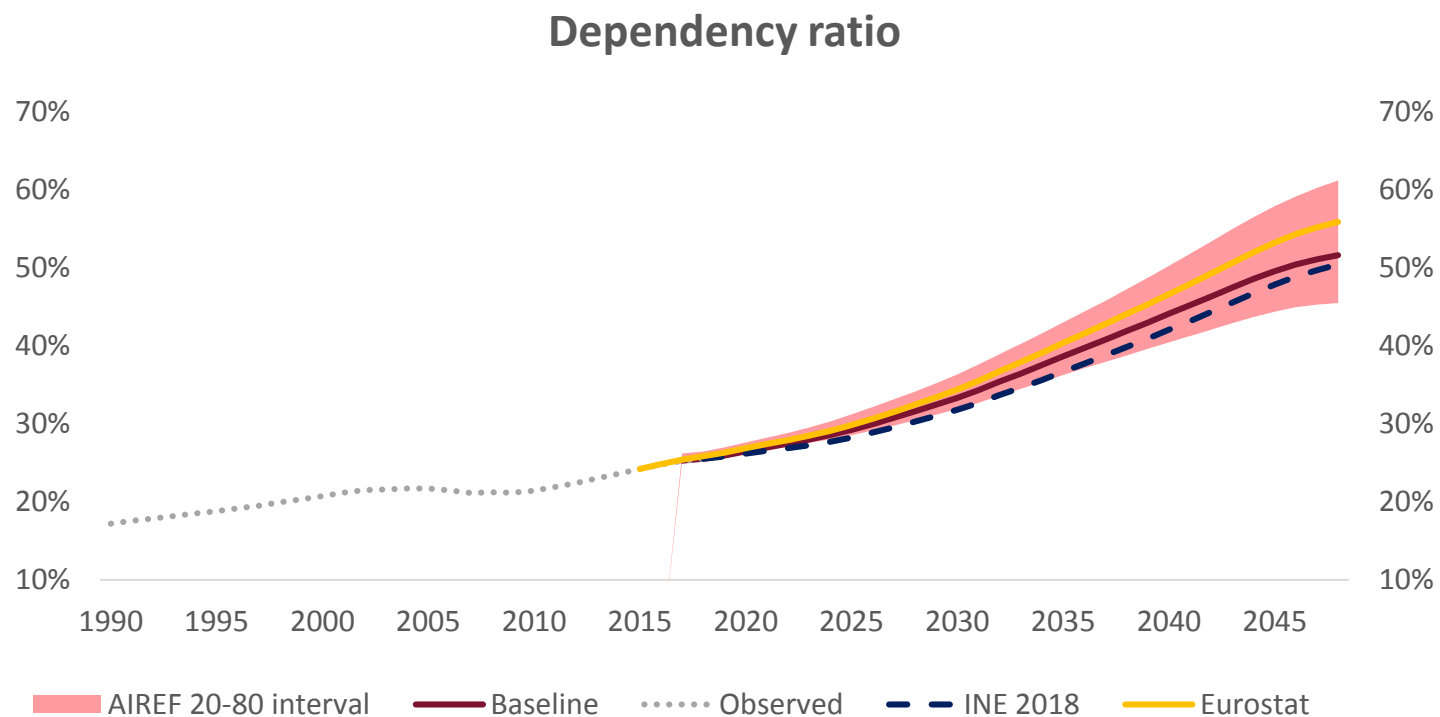
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- The increase in population is accompanied by a population ageing.
- The dependency ratio doubles in the next 30 years, standing between 45% and 60%

... how it is reflected in the projected evolution of the population pyramid...

1. Motivation

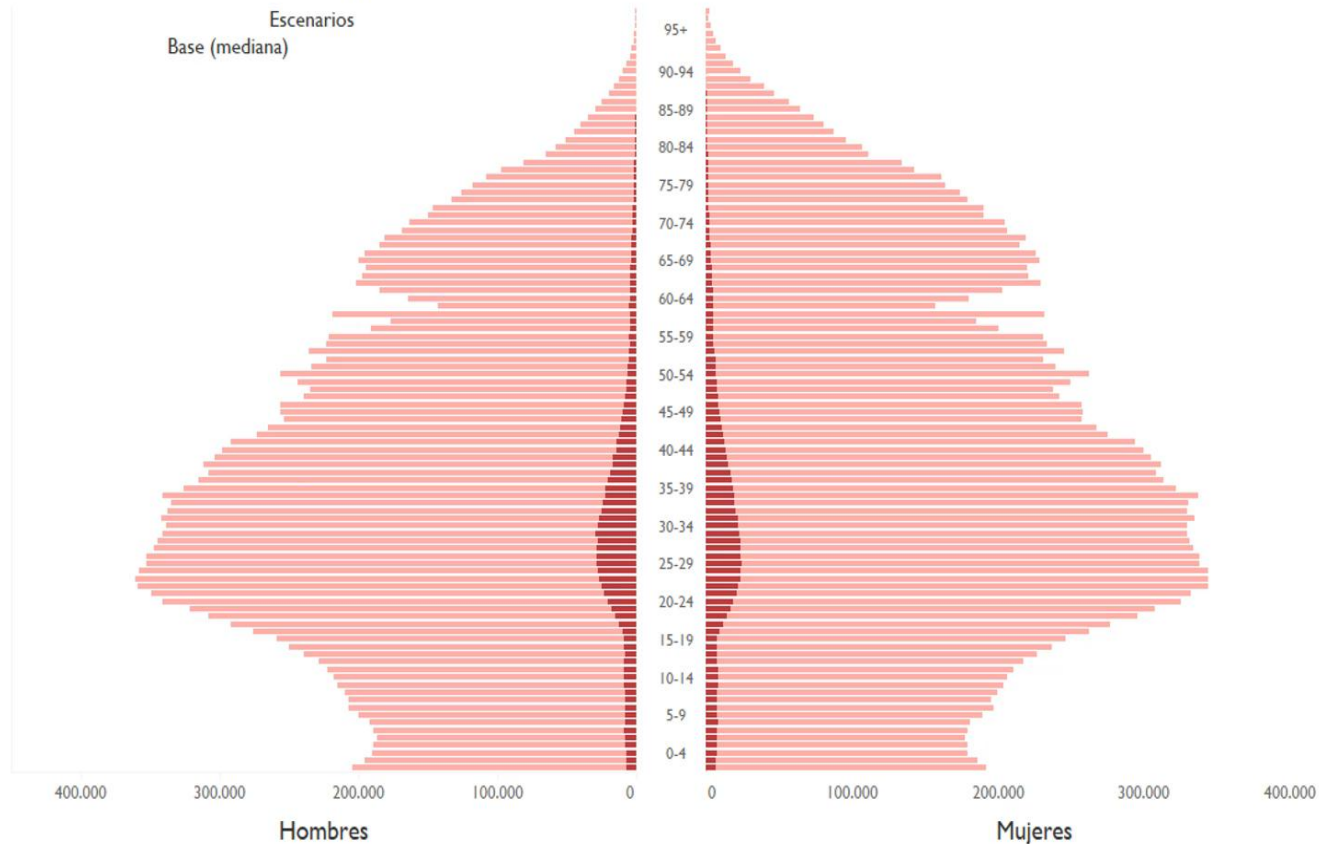
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Pirámide de población Año 2001



Población total

40.665.543

Española
Extranjera 2001

38.927.569 95,73%

1.737.974 4,27%

Población de 67+

5.993.853

Edad de trabajar (16-66)

28.260.736

Menores (0-15)

6.410.954

Mujeres

19.913.152

828.502

20.741.654

Hombres

19.014.417

909.472

19.923.889

Escenarios:

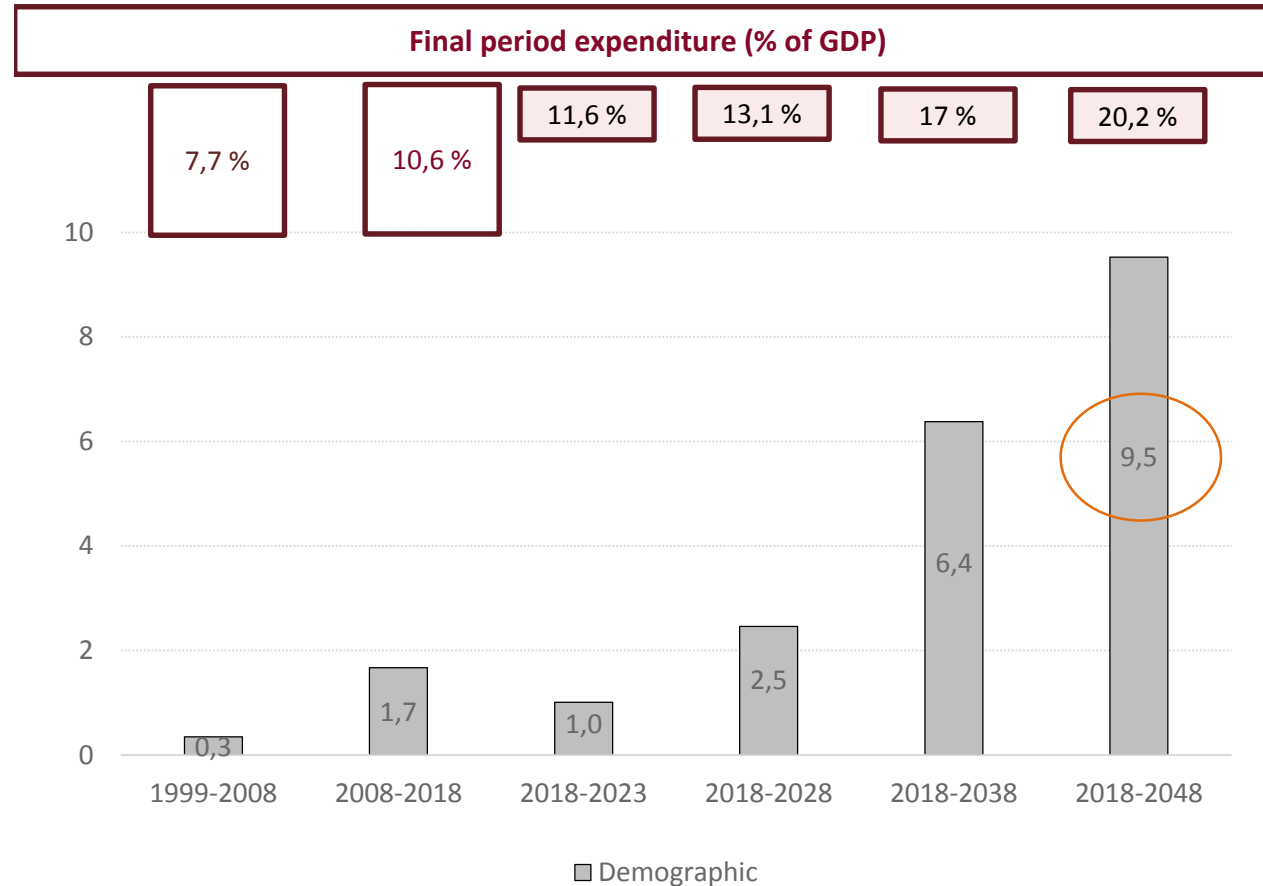
- Escenario base con hipótesis establecidas en la mediana
- Escenario en el percentil de distribución 20 de la tasa de dependencia: hipótesis de alta fertilidad, baja esperanza de vida y alta inmigración
- Escenario en el percentil de distribución 80 de la tasa de dependencia: hipótesis de baja fertilidad, alta esperanza de vida y baja inmigración
- Escenario en el percentil de distribución 20 de la población: hipótesis de baja fertilidad, baja esperanza de vida y baja inmigración
- Escenario en el percentil de distribución 80 de la población: hipótesis de alta fertilidad, alta esperanza de vida y alta inmigración

Fuentes: Instituto Nacional de Estadística y AIReF



...with an impact on pension expenditure of 9.5 percentage points of GDP until 2048

Explanation of the change in pension expenditure as a percentage of GDP (pp.)



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3. Long-term challenges

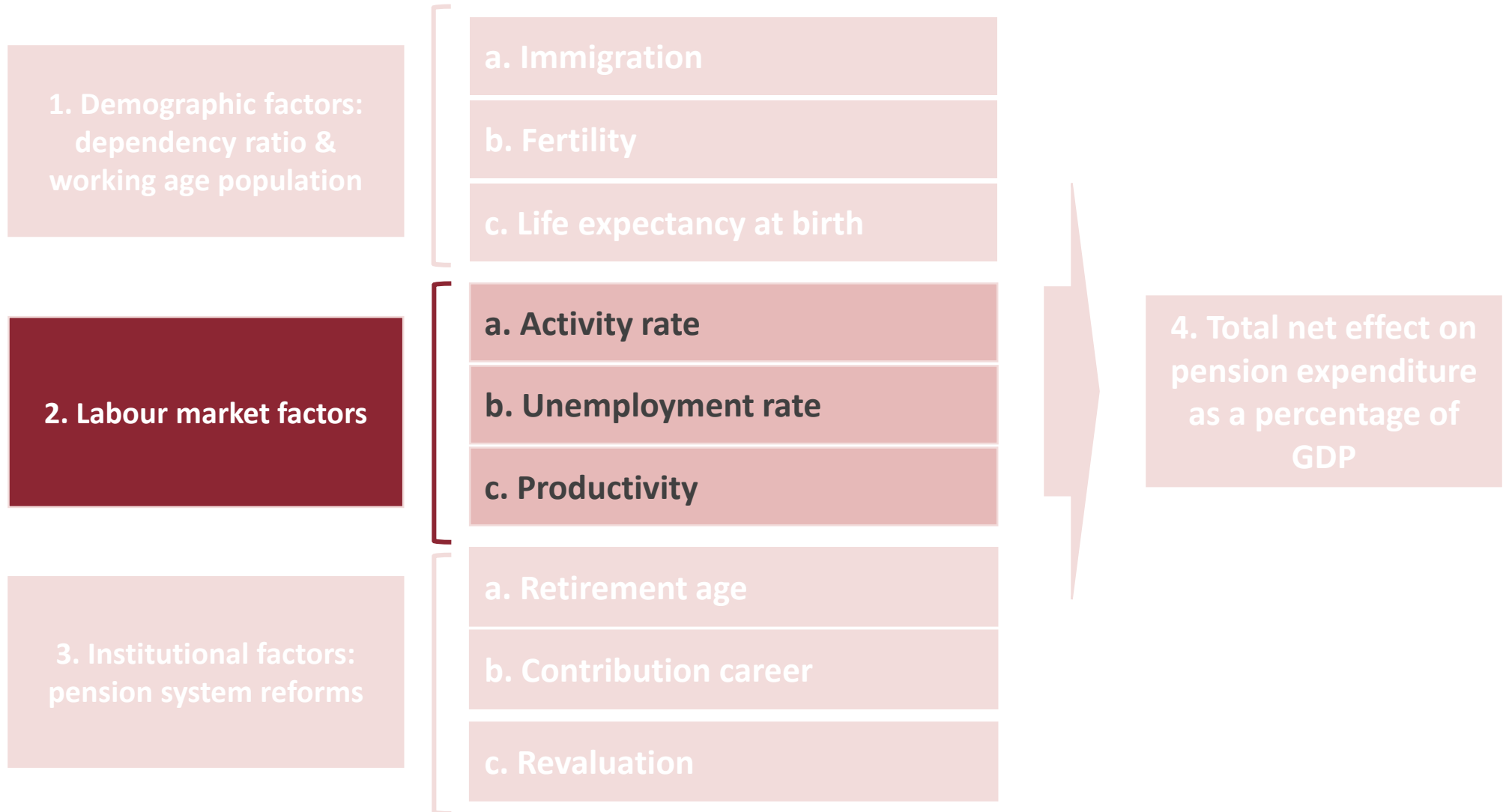
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3.2. Labour market factors

In the labour market the AIReF foresees...

a. Activity rate

The AIReF projects an increase of 1.9 p.p. in activity to 66.5% in 2048

b. Unemployment rate

A decrease is expected, converging at a rate around 8%

c. Productivity

It remains the great unknown for the future, with factors that affect in both ways. The historical trend has been 1%

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...and that we move from a model in which there is unemployment to one with an excess of available jobs



- Spain will move from a labour market model with unemployment...
- ...to a model characterized by a lack of workers to fill the available jobs

These labour market forecasts will contain pension expenditure at just over 3 percentage points of GDP

1. Motivation

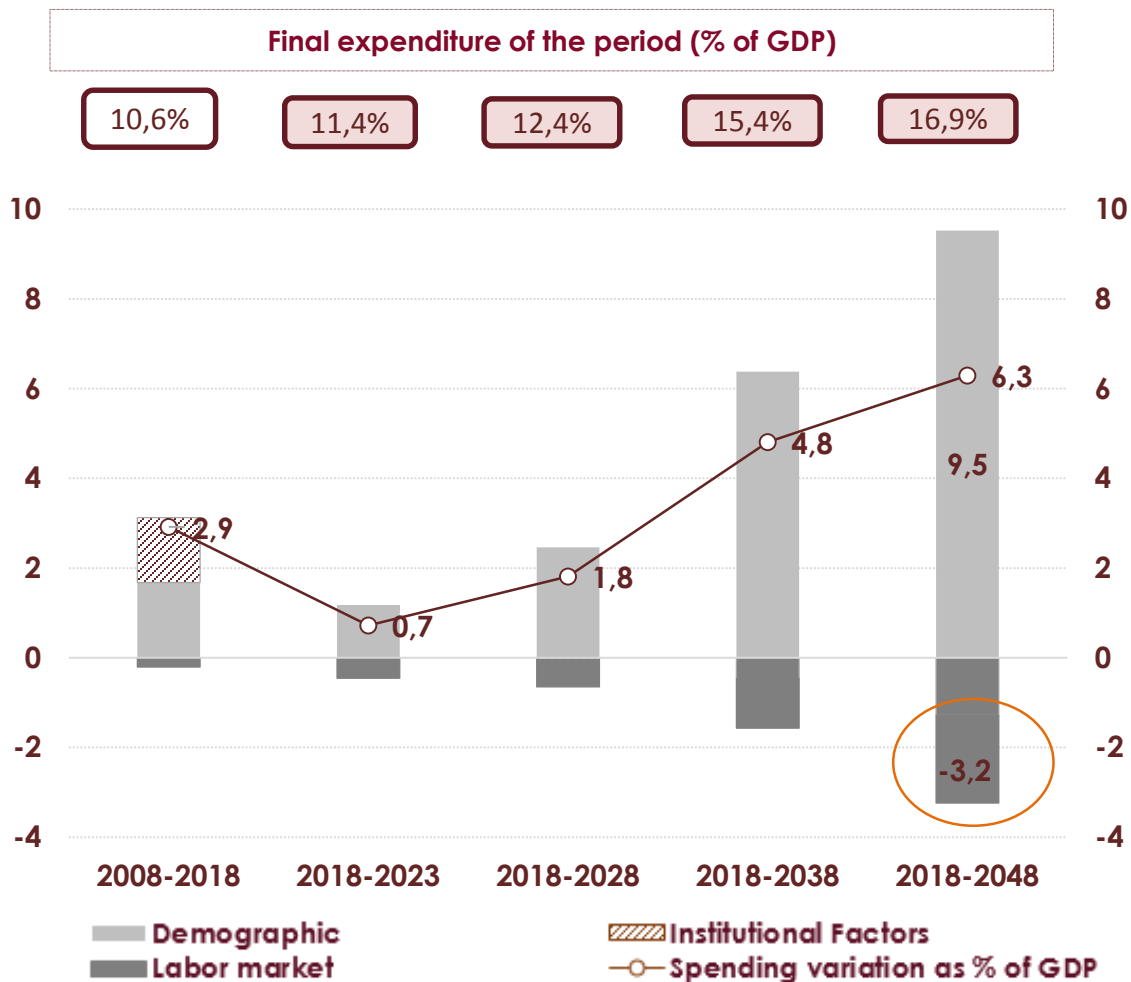
2. Structural deficit and short-term proposals

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Explanation of the change in pension expenditure as a % of GDP (pp.)



1. Scenario without reforms

- Without 2011 parametric reforms
- No Sustainability Factor
- Revaluation with the CPI

3. Long-term challenges

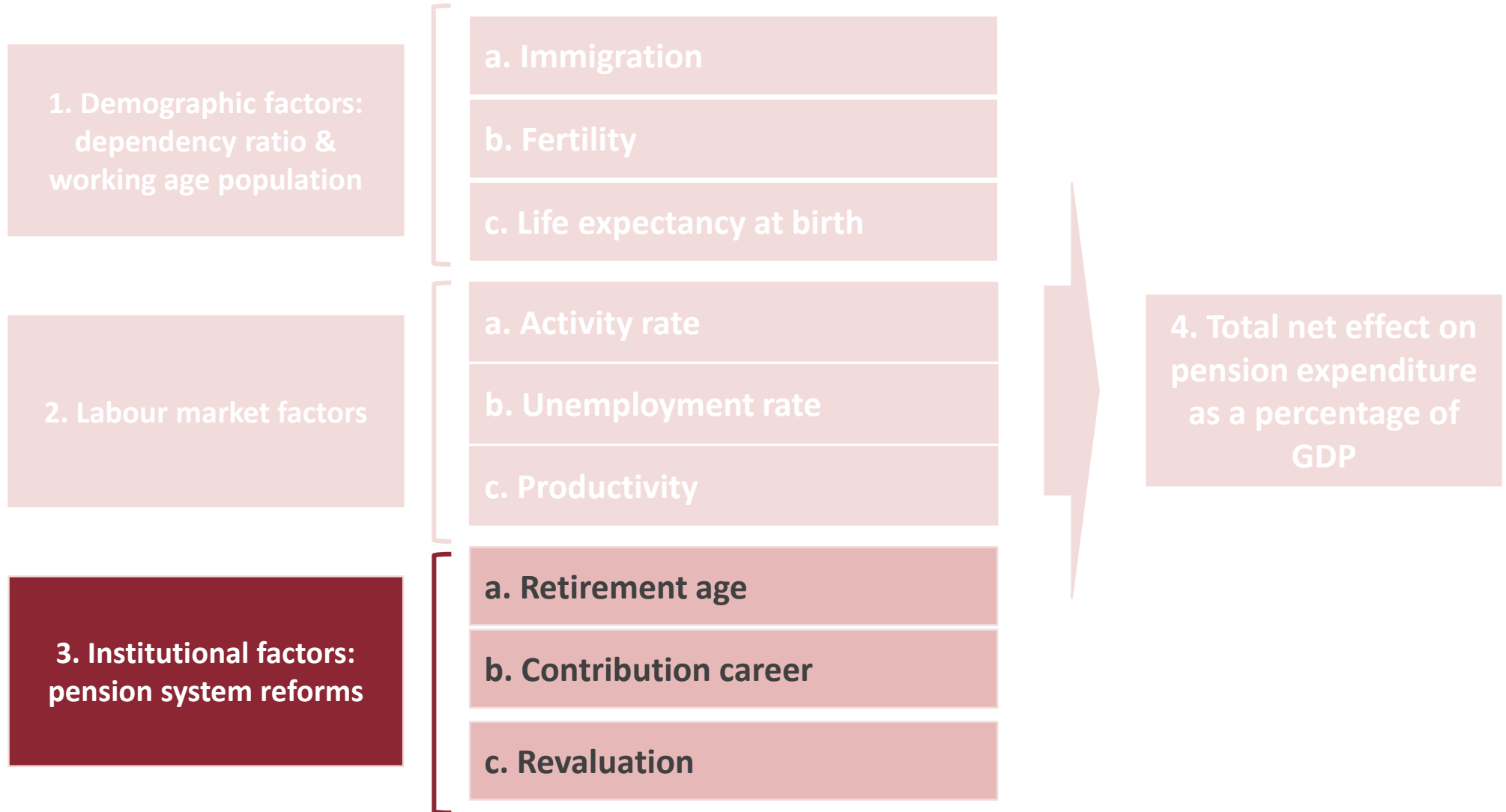
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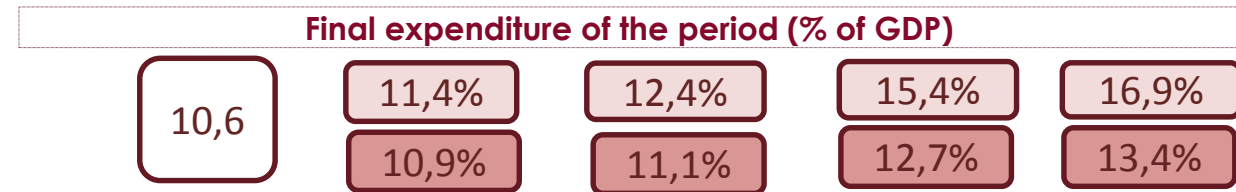
4. Long-term proposals & conclusions



3.3. Institutional factors

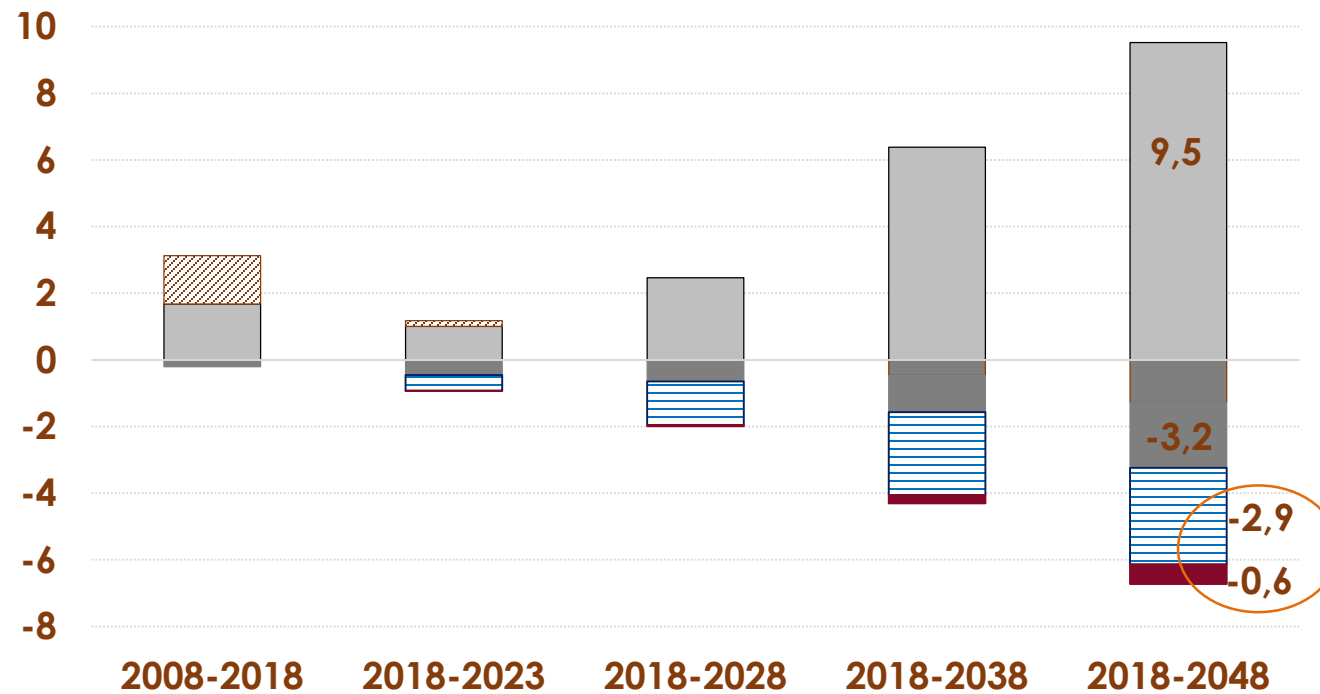
The 2011 parametric reforms and the Sustainability Factor additionally contain expenditure at 3.5 points

Explanation of the change in pension expenditure as a % of GDP (pp.)



- 1. Scenario without reforms
- 2. Baseline scenario with reforms

- With parametric 2011 reforms
- Application of the Sustainability Factor
- Revaluation with the CPI



- Demographic
- Institutional Factors
- Labor market
- Reforma 2011
- Factor sostenibilidad

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3. Long-term challenges

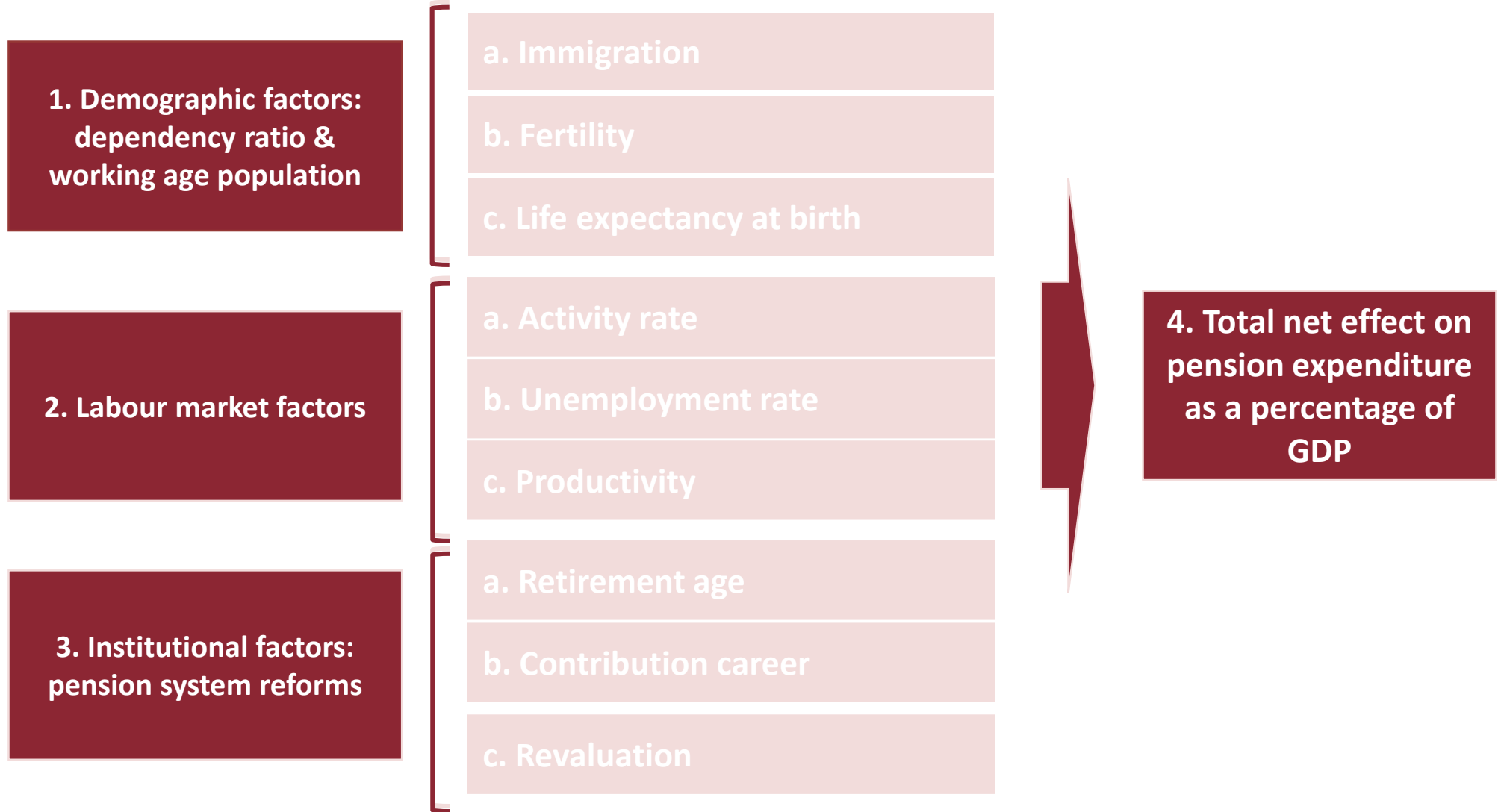
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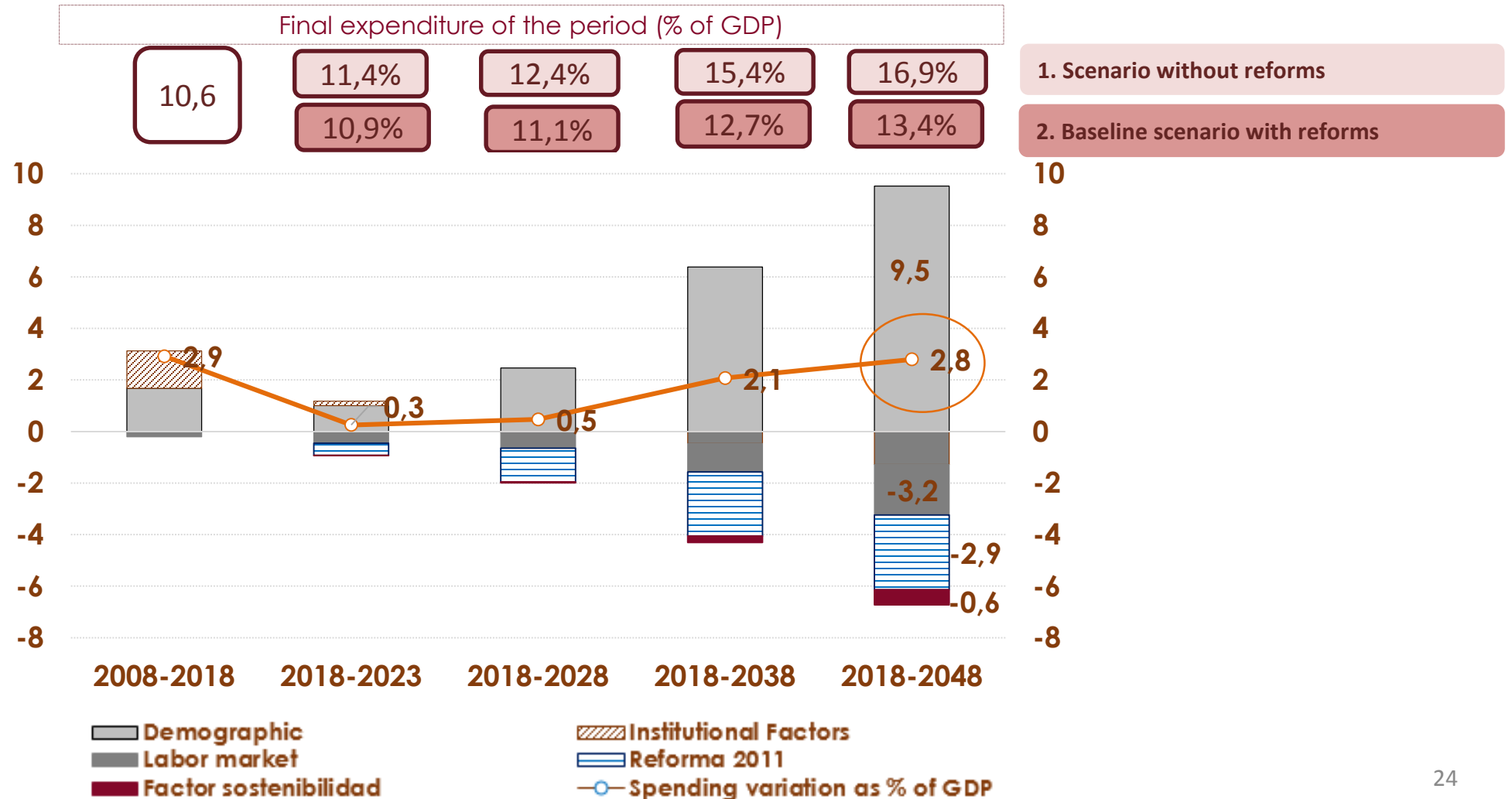
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3.4. Total net effect

The net effect of demographic factors, labour market and institutional reforms already approved, is an increase in pension expenditure of 2.8 p.p. in 2048 relative to 2018



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The 2.8 percentage points increase in pension expenses is associated with a lower coverage ratio and higher debt

Scenario	Year	Expenditure (% GDP)	Expenditure variation	Replacement ratio*	Debt increase (% PIB)
Baseline, with parametric reforms and Sustainability Factor	2018	10,6		57	
	2048	13,4	+2,8	53	49
Revaluation 0,25%	2048	11,3	+0,7	45	6

The revaluation of pensions at 0.25% per annum made it possible to contain the increase in expenditure by 0.7 p.p. in 2048 at the cost of reducing the replacement rate by 9 p.p.

*Replacement rate: average pension between average salary

- Demographic factors
- Labour market factors
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4. Reform proposals: Deepening of the 2011 parametric reforms

1. Motivation

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Scenario	Year	Expenditure (% GDP)	Expenditure variation	Replacement ratio*	Debt increase (% PIB)
Baseline, with parametric reforms and Sustainability Factor	2018	10,6		57	
	2048	13,4	+2,8	53	49
1. Retirement age change	2048	12,6	+2	55	26

There is progress in closing the gap between the effective age and the legal retirement age, which in 2027 will be 2.5 years

1. Effective retirement age in 2018: 62.7 years

2. In 2027, it is expected to reach 64.5 years at the end of the transitional period included in the 2011 reform.

3. Each year of increase in the effective retirement age thereafter results in savings of approximately 0.4 pp and a slight improvement in the replacement rate

4. Reform proposals: Deepening of the 2011 parametric reforms

Scenario	Year	Expenditure (% GDP)	Expenditure variation	Replacement ratio*	Debt increase (% PIB)
Baseline, with parametric reforms and Sustainability Factor	2018	10,6		57	
	2048	13,4	+2,8	53	49
1. Retirement age change	2048	12,6	+2	55	26
2. Increase in career years	2048	13,0	+2,4	51	41

There is capacity to increase the contribution career, comparatively low at the international level

Increasing the contribution career considered for the calculation of the pension from 25 years of the baseline scenario to 35 years in 2027 would mean a saving of 0.5 p.p. of GDP in 2050 without hardly affecting sufficiency

Reform proposals: Deepening of the 2011 parametric reforms

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1. Retirement age change	2048	12,6	+2	55	26
2. Increase in career years	2048	13,0	+2,4	51	41
Implementation of reforms 1 and 2	2048	12,2	+1,6	54	23

Jointly implement the reform of retirement age change and increase the contribution career would contain pension spending by 1.6 p.p., would improve the replacement ratio and would halve the increase in debt projected in the baseline scenario

4. Conclusions on long-term challenges and proposals

- Demographic pressure intensifies from 2030 onwards, increasing pension expenditure between 2 and 4 GDP points from its current level
- Labour market developments and the impact of the 2011 reform and the sustainability factor in 2013 contain the effect of ageing population



PROPOSAL FOR LONG-TERM IMPROVEMENT

Adopt measures that strengthen the sustainability, equity and sufficiency of the system, in particular:

- Encourage an increase in the effective retirement age
- Increase the career computation of the pension

The maximum saving would be close to that of the IRP

Its early and gradual implementation would increase its social acceptance



Independent Authority
for Fiscal Responsibility

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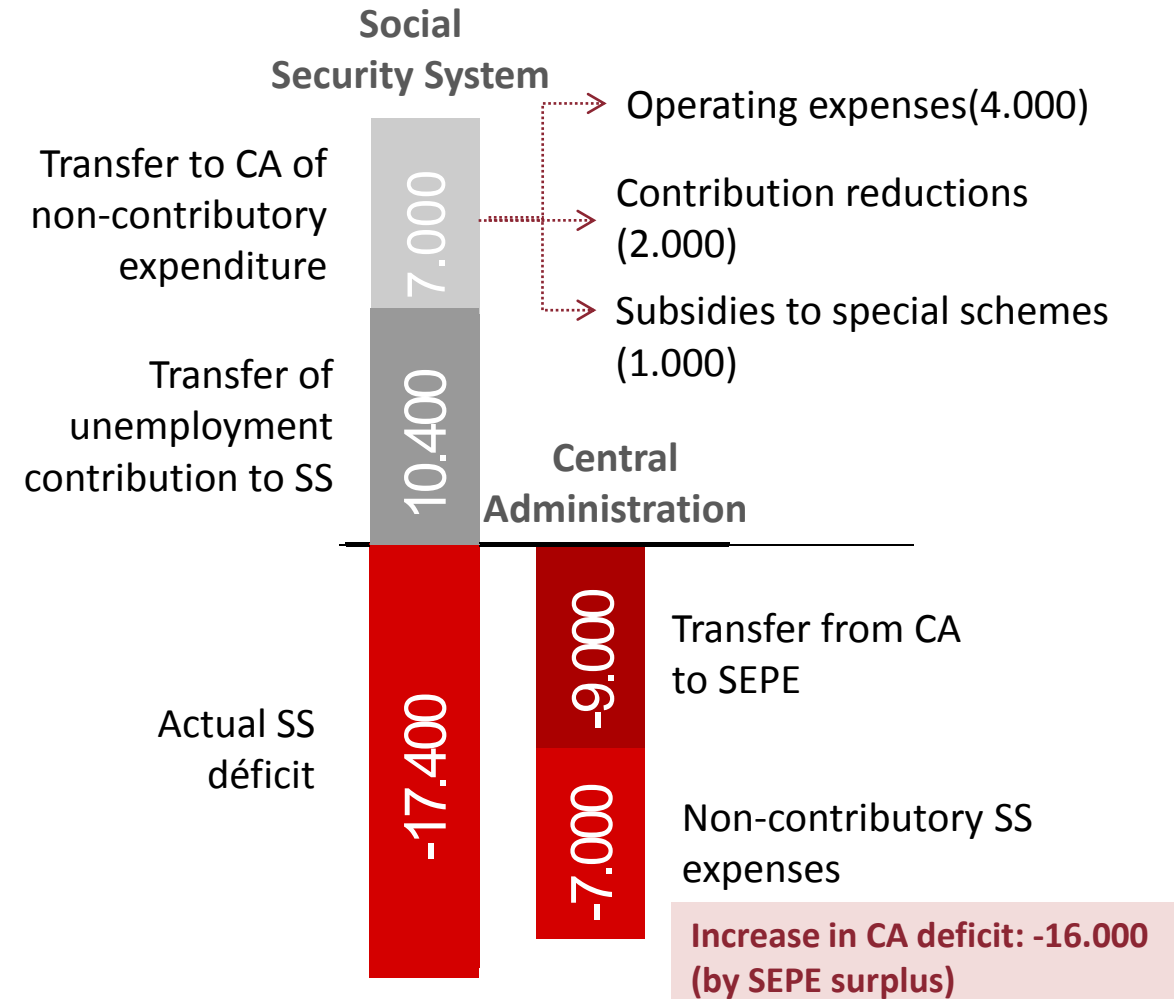


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The AIReF Opinion proposes that in the short term the structural deficit of the SS be closed through the transfer of spending responsibilities to the State

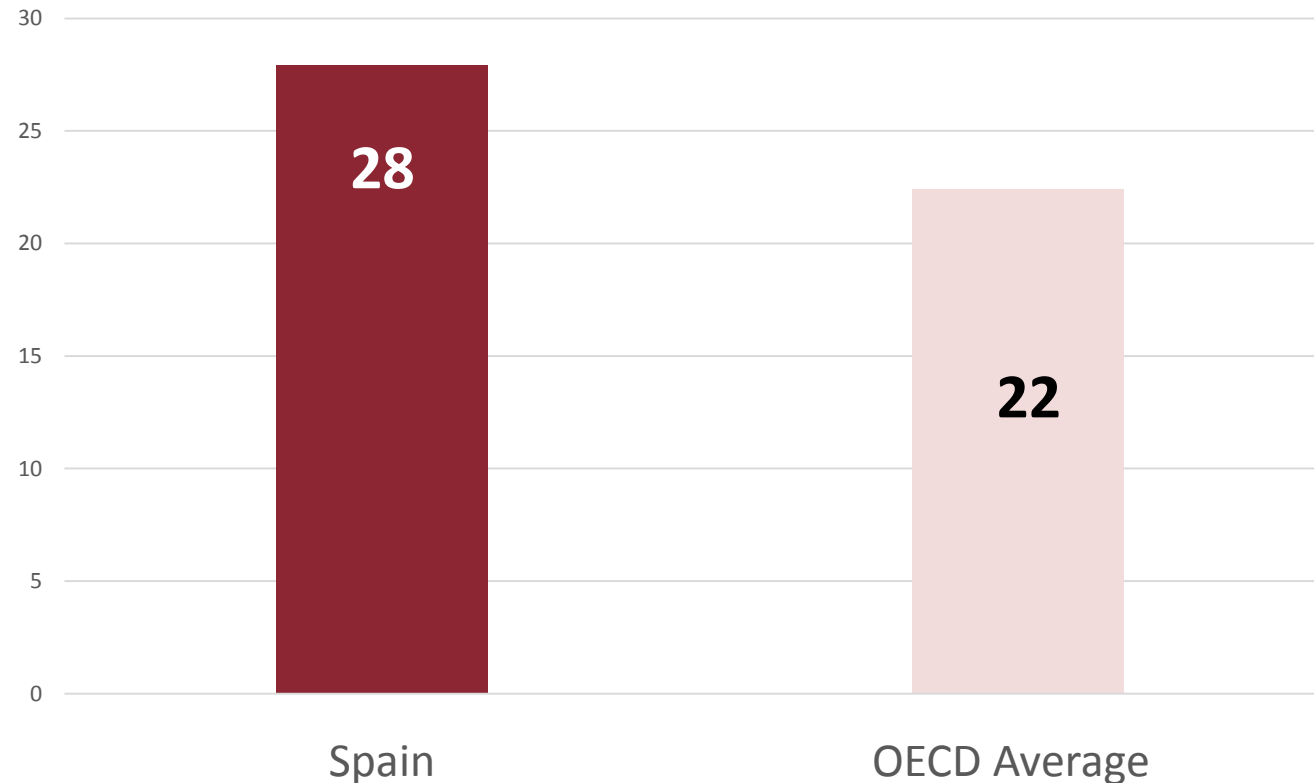
SHORT-TERM PROPOSALS

- I. Increase in the **contribution rate for pensions** offset by a reduction in the **contribution rate for unemployment**, with the State assuming the loss for the SEPE.
- II. Assumption by the State of **non-contributory SS expenses**: contribution reductions, implicit subsidies to special schemes, operating expenses or unemployment benefits.



Social contributions in Spain are relatively high, 6 points above the OECD average

Total Social contributions as % of labour cost



It is considered that any modification should not imply an increase in social contributions,
but only a reconfiguration of them.

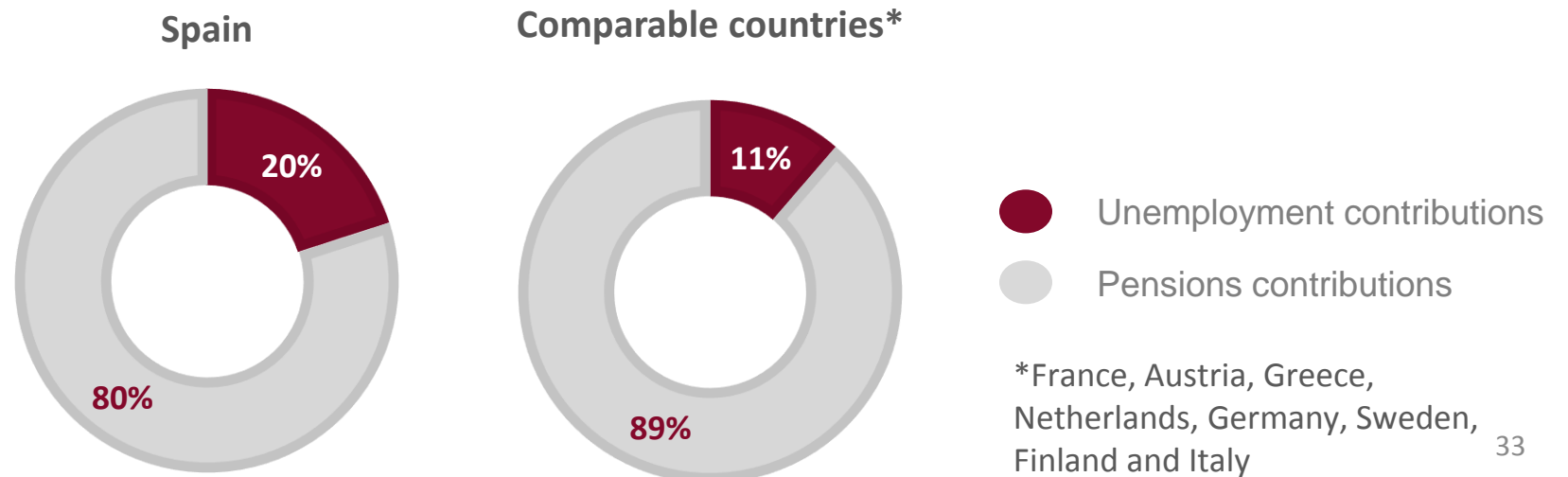
There is scope for reducing unemployment contributions and raising pension contributions

Unemployment and pension contributions in Spain (% of regulatory base)

Unemployment contributions	Pensions contributions	SUM
7,1%	28,3%	35,4%

Source: MITRAMISS, Economic-Financial Report 2018.

Unemployment-Pension Contribution Distribution



The proposed modification would imply recognition of the structural deficit by the central government, with the total remaining at 2%.

Structural balance by subsectors. As a percentage of GDP

	Current	Proposal
Central Administration	-0.8	-2.2
Social Security Funds	-1.4	0.0
Autonomous Communities	-0.2	-0.2
Local Corporations	0.5	0.5
TOTAL Public Administrations	-1.9	-1.9

- The deficit is visualized in those parts of the Administration that have the tools to reduce it
- Placing the deficit in the context of Public Administrations as a whole prevents uncoordinated and inconsistent decisions (tax cuts or expenditure increases) in specific subsectors