18th FIAP International Seminar:

Aging and the contribution rate are among the main challenges of the European pension systems

The head of Economic Analysis at BBVA Research, Rafael Doménech, analyzed the demographic changes in the coming years and the adjustments to the pension systems required for reducing the large gap between retirees and those who will have to work to pay for pensions.

For pension systems to be viable and sustainable, they must adapt to the ongoing economic, social and demographic changes in societies. The challenge is to find a **double balance**, explained the economist, Rafael Doménech, in his presentation "**The PAYGO pension systems in the current demographic context: the case of Europe."**

"The changes must be gradual, sustainable and credible to society. On the other hand, they must be applicable to generations and segments of the population that are affected by changes in the system. This is where this balance must be achieved," he said.

The main challenge facing the PAYGO pillar, a characteristic of the European public system, is the consequence of two demographic issues: the greater life expectancy of the population and the fact that younger generations are less numerous. The most worrying figure, as indicated in the projections, is that the dependency ratio (understood as the ratio of the population of 65 and over to the population between 20 and 64) will practically double, or come close to doing so, in European countries between 2020 and 2060. This means that the contribution rate would have to double to maintain pension levels.

As Doménech explains, there are four factors that determine the pension expenditure to GDP ratio, that need to be addressed when making future changes: the d**ependency rate** (the ratio of the population aged 65 or more to the population between 20 and 64)**; the coverage rate** (the ratio of pensioners to the population aged 65 or more), **the benefit rate** (the ratio of the average pension to GDP/employment) **and the employment rate** (the ratio of employment to population between 20 and 64). The most important of these are the pension and employment rates.

The forecasts enunciated in the presentation suggest that the pension expenditure to GDP ratio will inevitably increase by 1.5 percentage points, on average, in the next three decades.

European countries have had to take measures to bolster the sustainability of the public pension system. Among the measures taken are increasing the retirement age, mechanisms for rebalancing expenditure based on the deficit of the pension system, and changes in the criteria used for revaluing pensions (based on price increases, wages, or a combination of both).

The speaker explained that in order to address the aging issue, European countries can choose between different alternatives: lower the benefit rate; link pensions to life expectancy; raise the legal retirement age or increase the tax burden, introduce structural reforms that lower unemployment rates, increase the growth and employment rates, productivity and wages and promote a higher level of complementary savings to improve pension amounts sustainably.

"There are no definitive solutions, but rather gradual adjustments, because society is constantly facing new challenges. There are no free solutions either, since transferring the deficit to the State does not solve the problem. A social consensus is necessary to apply the adjustments fairly, efficiently and transparently," concluded the economist.

The presentation can be viewed on the seminar's website (https://seminariofiap.strim.cl/).