

Discussion on “Public Pension System and Labor Market” in Spain

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Summary on the pension system in Spain

- Is the pension system (PAYG) in Spain sustainable?
 - ➔ Demographic Reasons (not only in Spain but also in most developed countries)
 - ➔ What are specific problems in Spain?
Not much

Sustainability of "Pay-as-you-go" (PAYG) system

- Government's budget deficit or surplus:

$$d_t = N_t \tau_t w_t - N_{t-1} e_t + T_t - G_t - r_t D_t$$

- Evolution of government debt:

$$D_{t+1} = D_t - d_t$$

The sustainability of PAYG system

- Note that if the government balances its pension system, $e_t = \frac{N_t}{N_{t-1}} \tau_t w_t$
- So, pension payment increases with wages (labor productivity), contribution rates, and old-age support ratio (N_t / N_{t-1})
- The key problem is that old-age support ratio **will decrease significantly in the future.**
- The good news is that labor productivity (?) may increase significantly: 4th industrial revolution (?)

Why N_t/N_{t-1} will decrease significantly in the future?

- Demographic reason:
 - Longer life expectancy
 - Lower fertility rates

Possible solutions

- 1. Decrease pension benefits: e_t (limited)
- 2. Increase contribution rates: limited
- 3. Increase in government's borrowing (increase in the government deficit): limited
- 4. Increase in young population (N_t)
 - Work longer : retire later
 - More immigration
 - More incentives to have children
- 5. Increase in private savings
- 6. 4th industrial revolution

Conclusions

- Not enough to rely on pension payment
- May need to increase in private savings
- Wish a good luck about the influence of 4th industrial revolution.

Labor market in Spain

Labor market issues in Spain

- 1. High unemployment rates: 20% (What about Korea?)
- 2. High youth unemployment rates: 40% (What about Korea?)
- 3. High share of temporary contracts: 26%:
- 4. High share of long-term unemployment : this may be related to the long duration of unemployment insurance

Why have temporary contracts increased?

- After a radical two-tier labor market reform in 1984 (or early 1n 1990s) in Spain to fight high unemployment and to avoid high firing costs
- After the Asian financial crisis in 1997 (in Korea)
- Advancement in information technology (financial industry)

Labor market duality

- High share of temporary contract is viewed as an impediment to social stability and productivity growth → As a firing cost gap between permanent and temporary workers increases, firms tend to less likely convert temporary workers to permanent workers and to reduce the on-the-job-training investment for temporary workers. By knowing this, temporary workers tend to make less efforts. In turn, a firm's TFP (which combines productivities of temporary and permanent workers.) will decrease.
- This mechanism can be tested using firm level data: e.g. Ahn and Moon (2015) for Korean labor markets and Dolado et. al. (2013) for Spanish labor markets

Relatively high unemployment rates in Spain and Relatively low unemployment rates in Korea

- Need to consider the combined effect of the under-ground economy and generous unemployment insurance (duration and magnitude) in Spain: unemployment rates may be overestimated.
- Need to consider the effect of “economies of scale by a family” in Spain: the effects of unemployment rates may be over-evaluated.

- In Korea, the number of “unpaid family workers” is large. These are considered as employed. → unemployment rates are likely to be underestimated.
- In Korea, a sizable number of people belongs to “쉬었음”. They are considered as “not in the labor force”. → unemployment rates are likely to be underestimated.
- In Korea, the duration of unemployment is very low: no incentive to declare “being unemployed” → unemployment rates are likely to be underestimated.

High youth unemployment rates both in Korea and in Spain

- More serious problem in Spain is that high ability young workers do not tend to stay in Spain (Going to Germany, France, or UK among EU)