The need for an overhaul of retirement pensions and intergenerational relations.

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This paper examines intergenerational relations in Mexico set up by social security and retirement pensions. It is a subject that deserves keen attention because the severe crisis that is facing threatens its own existence and jeopardizes many social, economic and political aspects.

Intergenerational relations are part of the existence and function of every society in such a way that they are concomitant with the historic, social and economic development. They are closely bound to the characteristics and dynamics of population structures, thus now under redefinition because of demographic dynamics and the aging process. In one of the simplest forms but of the utmost importance, the population in productive ages is in charge of both, people who have loss capabilities because of aging and also the young generations that requires support for personal development and education. Resource transference can be done through informal systems like family and kinship ties, or formal and institutionalized as it is the case of public education and pensions. These schemes are part of the social and economic conditions and observe great diversity and complexity.

The essential characteristics that must fulfill a retirement system as a fundamental part of relations between generations are that: 1) it must be a universal scheme covering all the population; 2) granted benefits must be adequate; 3) it has to be fair and equitable; 4) should redistribute income and show solidarity between generations and social classes; 5) keep financial, economic and social sustainability. Unfortunately, none of these essential attributes is fulfilled. It is disturbing to realize that these deficiencies have not arisen concern enough, with the exception of financial sustainability. The practical reason for this specific focusing of attention is because social security and pensions are close to bankruptcy. Thus, the subject is now at the front of the political arena.

It must be stressed that financial difficulties of social security came from a diversity of origins. Main causes included are increasing life expectancies, poor management, and a faulty general economic system. But the principal reason of the canceling of its economic and social viability comes from policies that are guided by political interests and union pressures in favor of privileged groups, in disdain of the collective interest. A long-term State vision has lacked. Looking for just financial explanations and answers for social security problems is leading to failure. Real and long lasting solutions requires a holistic approach coordinating all the characteristics, aims and meanings of social security.

A main shortcoming is that social security is not for everybody, but all is paying the cost. From the economically active population, only 40,2 % is covered by social security, mainly composed by urban wage-earning workers. The larger part of the working population that is left without protection are the rural workers and those in a precarious informal sector, indeed those in more need of economic and social protection.

The lack of full coverage is just the beginning of inequity. Those that do have social security receive it in a diversified system, organized in many independent institutions. Each one of these agencies covers a special group of workers, whose benefits are in accordance with their ability of negotiation and union pressure. 77,1 % of the underwrite are the employees of private companies, with unsatisfactory benefits and very low pensions. 18,7 % works in the public sector, enjoying better benefits. 4,2 % are working in strategic sectors such as the oil industry, electrical production, banking and finance, public universities and high rank of government, which profit from benefits that go beyond a necessary protection and fall on the side of privileges.

Privileges are pensions requiring from the future retirees small contributions or none at all, allowing early retirement, granting high stipend pensions, updating pension allowances according to wages increases. A thought that describes this unfair indulgence says that it is true that there must be no risk without protection, but it is also true that no protection should be provided without an actual risk.

The combination of lack of cover and insufficient benefits for most of the economically active population along with the existence of outrageous privileges for a few, results in a lack of solidarity between social classes and a negative redistribution of resources due to the use of tax resources for financing social security and the cost of the pensions. Finally, it is not surprising that retirement pensions reproduce the general social and economic inequality existing in the country.

It has come with a shock, but the social security crisis cannot be regarded as a surprise. Several decades before there were actuarial reports and projections that addressed the mistake of granting privilege benefits without bearing in mind the actual cost and consequences for the future. A foretold crisis that finally arrived with remarkable punctuality.

A way to measure the economic burden from retirement pensions is to evaluate accrued liabilities as a lump-sum. That is, the present value of vested pensions using actuarial projections under a rate of discount. Using the projections of mortality made by the National Council of Population and the interest rate of 3,5 %, actuarial liabilities as a lump-sum are as high as equivalent to 1,1 times the GDP of the year 2003.

A pension is a transference of consumption between generations. Transfers go from productive population, mostly young, to those that are not longer productive because disabilities and unemployment related to old age. Essentially, there are two ways to do it. 1) One is by means of a promise in which future workers are required to share its production with people in retirement. This commitment can be the traditional and natural support from children and the family, but it can also be a social or State agreement such as a retirement pension that operates under the principles of defined benefits regulated by laws or labor contracts. 2) Another form is by saving money to buy the goods and services that in the future will be required during retirement. This it is the case of pensions plans individually funded by defined contributions.

In general a pension system does not follow one approach or the other. Most of the time it is a combination of both, but within a dominant type. In any case, a most relevant fact is that whatever the financial or social approach is, the only certain issue is that transferences and its deeds depend exclusively on the amount and quality of future production and how it is allocated. With very few exemptions the goods and services that the retired population requires must be always part of the output of the workers at the time of consumption. In this sense, a pension system must avoid policies that avert future productivity and should try instead to promote it. This is crucial point and it is necessary to consider that the sole comparison between financial systems is narrow minded. Social security and pensions must be regarded within the demographic and socio-economic system as a whole.

In 1997 the financial system of the Mexican Institute for Social Security (IMSS) was transformed. IMSS is the biggest organization and covers the employees working for private industry and business. The main reform is that new affiliates are now under a defined contributions scheme instead of the former defined benefits of a pay-as-you-go (paygo) system. The main arguments in support for the reform were that in this form it would be possible to fulfill the essential qualities of social security of universal coverage, fairness, solidarity, sufficiency and economic and social sustainability. Additionally, it was also claimed that two desirable characteristics would be acquired. One is that the new system would provide an important and increasing source of domestic savings thus boosting economic growth, employment and productivity. Another expected improvement would be to immunize social security from arbitrary government decisions and labor unions pressures.

After seven years from the IMSS reform it can be shown that there are not substantial improvements and that the system still shows serious deficiencies and has given place to new ones. The lack of covering has extended; the percentage of substitution of income by this new defined contributions plan will be very low; administrative costs are very high; it has a high fiscal price due to the cost of transition and the guarantee of a minimum pension; future pensioners are exposed to financial risks; opportunities for domestic savings and development are nil.

The failure on the assumptions about domestic savings deserves further comments. In fact capitalization of defined contributions in individual accounts remains mostly a paygo system. 83 % of the funds are invested in government bonds. This investment becomes part of the national debt that will be paid by taxing future generations. In this way, this new scheme actually keeps being a paygo system, but more expensive due to payment of commissions and interests. Additionally, the small part invested outside the government is only helping the biggest companies and better established. The medium and small industries and businesses are being neglected and new employment is not being created. From the social and economic point of view a serious shortcoming has been the abandonment of medical attention and social investment. This is affecting the young generations that otherwise could get better opportunities for health and training that would empower future productivity.

It is vital to review social security and pensions by going back to basics. Privileges have to be cancelled, and compulsory and voluntary savings must be a substantial part of the productive organization helping the economy and employment growth. Concrete proposals are now under discussion about the concept of several pillars: a universal minimum pension financed from general taxes; a contributing basic pension in a pure paygo system; a compulsive fully funded pension above certain wage amount with a ceiling; and finally a voluntary savings component.

The predicaments of social security and the consideration of retirement's privileges have produced high political friction. It has been pointed out how the present system creates economic inequality and raises economic and social risks, arousing antagonism between generations. It now comes into questioning how unfair are the already vested excessive benefits and how the cost is shared by everyone, including the poor that are not even aware that they are also bearing the cost. Reforms and alternative routes are explored based on demographic and actuarial projections. A key element is to yield political short-term attitudes in favor a long-term State foresights. Hazards exist about the weakening of social and familiar cohesion in a conflict between generations. An obligation of the State is to distribute the loads between generations in a correct form. There is an imperative to redefine the principles and the ethics of the social security an retirement. New intergenerational relations do need renovation of social contracts.