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News Release

First pillar prospects: More kids or more reforms?

Raising children is notoriously expensive in modern-day Switzerland, but the joys of parenthood are worth the costs...right? Generations ago, children were profitable investments, as they were a cheap source of labor and old-age insurance for their parents. While our society still relies on the next generation to finance our first pillar pensions (OASI), a new report from UBS examines the link between OASI financing and raising children, highlighting the disconnect between our individual and collective view of children.

Zurich, September 15, 2020 – Parents shoulder high costs in raising children but do not get more retirement benefits in return. Swiss society has redistributed the benefits of children more than it has shared the burden of their costs. The fairness — to parents or childless individuals — of a system that relies on a sufficiently large next generation to finance state pensions continues to be a contentious topic.

Unequal distribution of burdens

All else equal, childless individuals pay more taxes and receive fewer social benefits than their childrearing peers during their working years. But as UBS economist Jackie Bauer points out, "on balance, raising children impedes the wealth accumulation potential of parents and weighs on their financial security in retirement." Tying pension and child financing closer together would reduce the financial burden on parents. However, doing so does not guarantee that a sufficient number of children will be born, and, at its core, the OASI relies on that next generation.

Can a new baby boom save the OASI?

With the number of retirees increasing faster than the number of workers, the OASI's finances are in jeopardy. Reform discussions have been underway for some time, but compromise is difficult to achieve since the long-term consequences of sticking to the status quo are hard to grasp. The latest UBS CIO GWM report *Kids and Pension: A complex cost-benefit relationship* is a thought experiment that looks at how many children would be needed to sustain the OASI in the long term if reforms are not implemented.

The authors argue that relying on demographics alone to rescue the system is ill-advised, at best, as a modest rebound in fertility would be of little help to the system. Without reforms, around five children per woman would be needed to bring the OASI fund back to equilibrium by 2070. As James Mazeau, economist at UBS, notes, "such a high fertility rate is clearly not a realistic option, and, regardless, the OASI should work no matter the number of children" (see Figure).

Same ambitions, different model

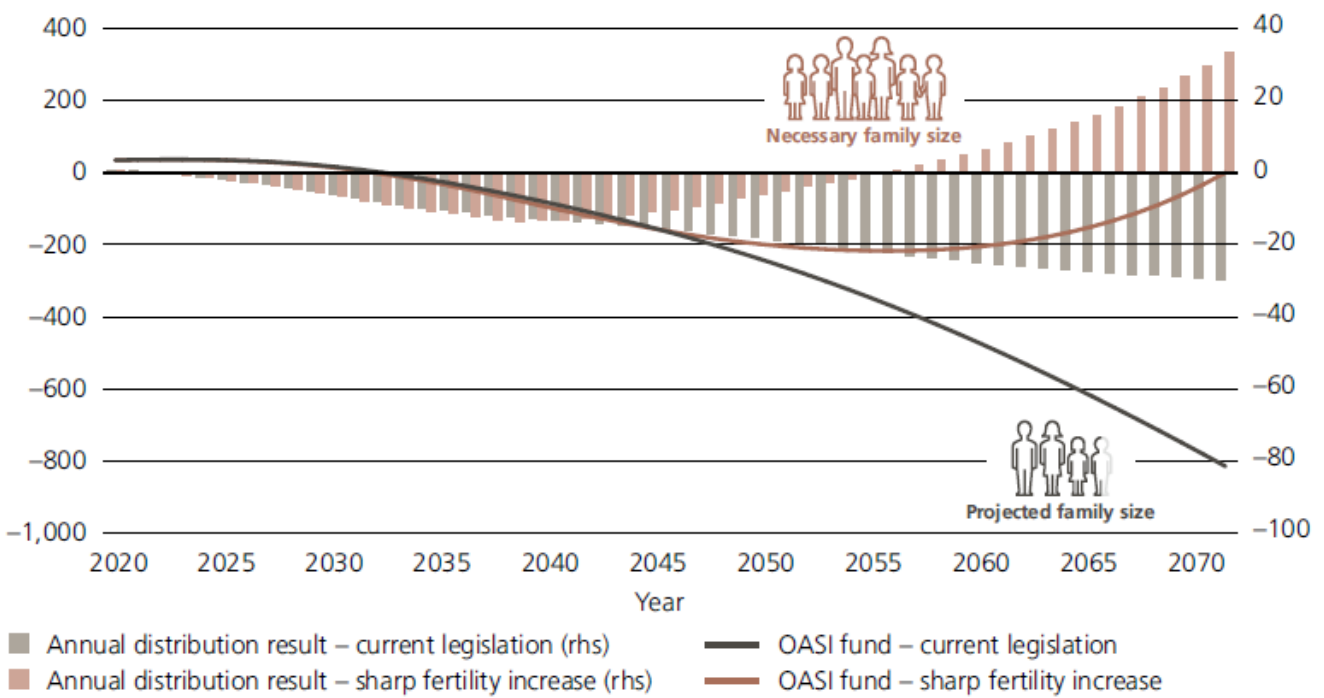
The current financing of the OASI is out of sync with today's society. Progressive reforms are needed, as the age of high fertility is long gone. Retirement age, contributions, and payouts could be dynamically adjusted,

based on rules, in response to demographic developments. Unsurprisingly, redistributive models rely on a combination of contributions and taxes. The challenge lies in finding the right balance between the two. Adherence to social norms, a shared sense of fairness, and confidence in the pension system’s financial future are key to sustainably fulfilling the OASI’s ambitions.

Figure

OASI fund and distribution result projections by scenario

in CHF billions – A negative amount means that the OASI system has debts



Source: UBS, FSIO, FSO, 2020

For more information and access to the publication please visit: www.ubs.com/vorsorgeforum/en.

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