Spain: Parliamentary recommendation to revalue the level of pensions in line with the consumer price index

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On 10 October 2018, the Parliamentary Commission of the Toledo Pact approved the Recommendation on the "Maintenance of the purchasing power and improvement of pensions", according to which the annual revaluation of pensions will be based on the consumer price index. This Recommendation has reopened the debate on the future sustainability of the Public Pension System in Spain.

Description

The Parliamentary Commission of the Toledo Pact was created in April 1995 to reach consensus on a permanent reform of the Public Pension System (PPS) in Spain by means of Recommendations that were broadly applied until 2011.

In January 2011, this Commission recommended that pensions be revalued annually on the basis of the consumer price index (CPI). However, in 2013 the government did not take this recommendation into account, but established a new Pension Revaluation Index (PRI) calculated according to the financial balance of the PPS. Its value varies between a minimum increase of 0.25 %, and a maximum which could be the consumer price index plus 0.5%. The PRI formed part of the package of measures making up the 2013 Spanish pension reform, enshrined in Law 23/2013. The PRI entered into force on 1 January 2014.

With low inflation rates, this index did not affect the purchasing power of pensions between 2014 and 2015, but has done so since 2016. Due to demands and protests by pensioners' organisations and coinciding with the change of government in June this year, pensions have again been updated according to the CPI (a temporary measure). In July 2018 the government topped up the initial PRI of 0.25% with 1.35% for contributory retirement pensions and 2.75% for minimum and non-contributory pensions in order to realign these with the expected variation in the CPI. The additional economic cost is estimated at €1.6 billion for this year.

The Commission of the Toledo Pact returned to the 2011 recommendations. On 10 October, it approved Recommendation No 2 on the "Maintenance of the purchasing power and improvement of pensions", according to which pensions will be revalued annually on the basis of the CPI, as a way of preserving the purchasing power of pensions. This Commission considers that "the sustainability of the system requires that only the expenses corresponding to the strict maintenance of the purchasing power of pensions be financed from Social Security resources".

Outlook & commentary

The Recommendation, which has not yet been implemented, responds to the demands from the pensioner population, thereby restoring social peace. It also re-establishes a relative "institutional balance", since the 2013 pension reform was decided without the consensus of the Toledo Pact. The Commission has not yet completed the set of Recommendations on reform and sustainability of the PPS. The latter is the subject of intense political debate (European Commission, 2018).

The PPS has been in a situation of structural deficit since 2010. This is partly a consequence of the increase in the dependency ratio (a 2.62

percentage point increase between 2010 and 2017), the fall in employment, the devaluation of wages and the high levels of temporary employment. Between 2008 and 2017, expenditure on pensions increased by 45% and the pensioner population by 12%. The contributing population decreased by 17% in the same period and the revenue from Social Security contributions fell by 7.5%. These contributions in Spain are three percentage points lower than the average for Eurozone countries (Ferreras Alonso, 2018). The system had a deficit of 1% of GDP in 2012, and of 1.8% in 2017. This deficit has been partially offset by the Social Security Reserve Fund established in 2000. This fund has been almost exhausted, shrinking from €66.814 billion in 2011 to €8.095 billion in 2017. The PPS has had to resort to consecutive loans from the state to cover the deficits.

The debate on the sustainability of the PPS can address expenditure or revenue. In terms of expenditure, it does not seem possible for the government to intervene without seriously compromising the purchasing power of pensions and increasing poverty rates (Montserrat Codorniu, 2016). Hence the questioning of both the index applied between 2014 and 2017 and the sustainability factor (intergenerational equity factor), the application of which was foreseen in 2019, although the Government has postponed it to 2023.

For this reason, most debate has focused on revenue. One option is to increase the contribution rate, but this does not seem desirable because of the resulting increase in the cost of labour. The debate has therefore focused firstly on rationalising expenditure (e.g. the state, not the Social Security System, is to subsidise active employment policy contributions) and, secondly, on the development of alternative ways of financing pensions, such as through taxes, either general taxation or new taxes. This latter alternative is preferred by the public financial authorities (Governor of the Bank of Spain, 2017). Such financing could be through indirect taxes (Hernández Cos & Jimeno, 2017) or through the entire tax system (Ferreras, 2018; Rodríguez Cabrero, 2017; Zubiri, 2016). This latter proposal would follow, for example, the financing trends in France and Germany.

Further reading

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