Spain adopts a law to enhance the adequacy and financial sustainability of the public pension system

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On 22 December 2021, the Spanish Parliament approved a law aimed at guaranteeing the purchasing power of pensions and improving the adequacy and financial sustainability of the Social Security system in the short and long term. The reform is a step forward in the protection of pensioners against poverty and is socially fair, as the ravages of the 2008 crisis on the finances of the Social Security system will not be passed on to pensioners alone.

Description

On 22 December 2021, the Spanish Parliament approved the "Law on guaranteeing the purchasing power of pensions and other measures to reinforce the financial and social sustainability of the public pension system". This reform of the pension system had been announced in the *Recovery, Transformation and Resilience* Plan, submitted by the Spanish government to the European Commission on 30 April 2021.

The reform overlaps with measures adopted in 2011, as some of these are still in the deployment phase, such as: the progressive increase of the pensionable age to 67 in 2027 and the increase of the number of years of contribution required for entitlement to 100% of the old-age pension, which would amount to 25 years in 2022.

The measures that make up this reform are grouped into two blocks. The first block includes measures aimed at legally guaranteeing the purchasing power of pensions. To this end, the "ad-hoc" revaluation index defined in the 2013 reform, which intrinsically did not allow more than an annual increase of 0.25%, is repealed and pensions are updated in line with the previous year's inflation. Other measures are established to improve the balance between pension spending and contribution income, penalising early pensions and promoting later retirement.

The second block of reforms includes measures aimed at maintaining the financial balance of the system. In the short term, to restore the financial balance of the contributory pension system by 2023 at the latest, the State is required to make annual transfers to the Social Security budget to cover "improper expenditure" of the system (such as exemptions to contributions for active employment policies among others) and non-contributory benefits (such as maternity/ paternity benefits, Minimum Living Income, benefits for people in a situation of dependency).

In the medium and long term, the most important measure seeks to ensure intergenerational balance and equity when the baby boom generation reaches pensionable age. The sustainability factor approved in the 2013 Law, which proposed a cut in the pensions of new retirees in accordance with estimated life expectancy, is repealed. Instead, the new law includes an "Intergenerational Equity Mechanism (MEI)". The MEI establishes extra financing for ten years, between 2023 and 2032, increasing the social contribution by 0.6%, split between employers (0.5%) and employees (0.1%) in the same proportion as currently established to cover common contingencies. This additional income is allocated to the Social Security Reserve Fund and will be used as of 2033 to finance possible unplanned pension spending, with an annual maximum available equivalent to 0.2% of GDP. If the Reserve Fund is not enough to cover possible spending gaps, a reduction in pension spending or an increase in contribution rates will be proposed.

In addition, the government is promoting a law that regulates the Employment Pension Funds with a State guarantee. The aim is to encourage pension plans that are complementary to the old-age pension, open to both salaried persons and self-employed workers. It is expected to be approved in mid-2022.

According to government estimates, the pension reform will result in an increase of spending of 3.3 percentage points (pp) of GDP, rising from 12% of GDP in 2021 to about 15.3% in 2050, including the effect of raising benefits in line with the Consumer Price Index (CPI). The economic impact of the revaluation of pensions according to the CPI and the use of 2020 as a reference base will result in the following increases in spending: 1.4pp of GDP in 2030, 2.3pp of GDP in 2040 and 2.7pp of GDP in 2050. The government argues that the increase in expenditure due to the revaluation of pensions in line with the CPI could be offset by a 10pp increase in the employment rate of the over-54s. Other measures, such as the extension of working careers, would reduce pension expenditure by 1.13pp of GDP in 2050 if 40% of those who retire delay their retirement by three years (MISSM, 2021).

Outlook and commentary

Financial imbalance is the main problem facing the Social Security system. The structural deficit of the Social Security system has become entrenched since 2011 at around 1.3%-1.5% of GDP and is estimated to reach 1.5% of GDP in 2022. Between 2011 and 2020, the Social Security system accumulated a deficit of 166 billion euros. The first years with negative results were covered by the Reserve Fund (created in 2013 to guarantee pension expenditure in periods of economic crisis), but from 2017 onwards this gave way to loans from the state, which, between 2017 and 2021, have amounted to 82.02 billion euros, to which should be added 6.98 billion euros planned for 2022.

The law has attracted both unfavourable and favourable assessments. The former focus on the impact of pension spending on state finances and the latter on the impact on pensioners' incomes.

The *unfavourable assessments* highlight that the measures included in the law do not solve the problem of the structural deficit of the Social Security system, estimated at around 1.5% of GDP. The calculations made by BBVA Research indicate that, despite the economic recovery, the deficit of the contributory system will not fall below 2.5pp of GDP in 2023, which will require greater transfers than planned. They stress that covering the deficit with state transfers has a perverse effect by causing an increase in public debt, which is detrimental to the country's economy (Bandrés, 2019; Hernández de Cos, 2021; De la Fuente, A., García Díaz, M.A. and Sánchez, A.R., 2018).

The *favourable assessments* are made by the Independent Authority for Fiscal Responsibility (AIReF), the Economic and Social Council (CES) and the majority workers' trade unions (UGT and CCOO). The AIReF (2019) is in favour of meeting the Social Security structural deficit by means of transfers from the state. The trade unions UGT and CCOO (2021) highlight the importance of the agreement, which repeals the most controversial aspects of the 2013 pension reform, guaranteeing the purchasing power of all Social Security and "civil service pensions" (a special scheme for state civil servants, currently being phased out) while establishing important commitments to ensure the sustainability of the system.

Further reading

AIReF (2020). Actualización de las previsiones demográficas y de gasto en pensiones. Opinión sobre la sostenibilidad del sistema de la Seguridad social. Opinión1/1/. Madrid: AIReF.

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De la Fuente, A., García Díaz, M.A. and Sánchez, A.R. (2018). La salud financiera del sistema público de pensiones español: proyecciones de largo plazo y factores de riesgo. Fedea Policy Papers, 2018/03.

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MISSM (Ministerio de Inclusión, Seguridad Social y Migraciones), (2021). Memoria del análisis de impacto normativo del anteproyecto de ley de garantía del poder adquisitivo de las pensiones y de otras medidas de refuerzo de la sostenibilidad financiera y social del sistema público de pensiones.

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