COUNTRY SPOTLIGHT | SPAIN

Seeking a sustainable system

Spain is reforming its public pension system to ensure its sustainability, but how effective are these reforms likely to be? Jack Gray **investigates**

Like many of its European counterparts, Spain's population is ageing and putting pressure on the country's pension system. An increase in the number of pensioners and a reduction in the number of workers have led to concerns over the system's affordability. "Spain, like the rest of the European countries, has an important demographic challenge that will have a relevant impact on the sustainability of the public pension system, intensified by the access to the retirement pension of baby boomers," notes CPPS Asesores managing director, Mariano Jiménez.

The European Commission's (EC) recent *Ageing Report* for 2024 forecast that Spain was the EU country in which public pension spending would increase the most compared to the 2021 scenario, predicting it would have risen by 3.3 percentage points in 2050 and by 5 percentage points in 2070, due to the 2021-23 reforms. While income from contributions is expected to increase by 2 percentage points to 12.6 per cent between 2023 and 2050, the EC forecast this would be insufficient to cope with the expected advance in spending on pensions.

"Pensions are, by far, the largest item in the general state and social security budgets," says Santander Asset Management head of pensions, José González. "Among the main factors that influence the growing pension expenditure is their revaluation based on the Consumer Price Index (CPI), the new pensioners who access this condition and a greater life expectancy.

"Furthermore, a low birth rate and level of unemployment directly affect lower social contributions. This circumstance, together with the fact that contribution income does not grow to the same or greater extent than pension expenses, will be an added difficulty for controlling the system's deficit, which will continue to be combated through transfers made by the state to social security."

Current sustainability

Despite the concerns, many believe that the public pension system is sustainable for the long term, and that appropriate measures will be taken to keep it that way. "First of all, it should be clarified the public pension in Spain is secure in the long term," states an Aegon Group

spokesperson. "However, what must be taken into account is that, in the coming decades, there could be a fall in the replacement rate. In this scenario, it is advisable for workers to have private saving plans to supplement their public pension and thus maintain their purchasing power at the time of retirement."

BBVA Research head of economic activities, Rafael Doménech, adds that the system is sustainable as long as the government continues to act to ensure its affordability. The Independent Authority for Fiscal Responsibility (AIREF) will assess the pension spending gap in 2025 and likely ask the government to propose either revenue or expenditure measures to close any shortfall. "If there are no measures, on 1 January 2026 there will be an increase in social security contributions," explains Doménech. "I'm not sure additional measures will be implemented next year because you always have the adjustment mechanism to say contributions will increase if there is no agreement.

"We assume the system is sustainable, and we assume that these conditions will be met because the political cost of having the system with this deficit will be so huge that, at the end of it, there will be some agreement to avoid a situation where the system would be unsustainable."

Although these conditions are in place, WTW Spain Retirement associate director, Rafael Villanueva, concedes that public pensions are under "considerable pressure, which calls into question its long-term sustainability".

"The current distribution model, based on the principle of intergenerational solidarity, faces critical challenges due to an ageing population and one of the lowest fertility rates in the world," he continues. "We will have to see how the macroeconomic variables evolve, but every indication, including the recent opinion of the EC, suggests that additional measures will be necessary, including possibly on the expenditure side too."

"EARLY RETIREMENT AND LATE RETIREMENT REFORMS HAVE BEEN UNDERTAKEN TO DELAY THE EFFECTIVE RETIREMENT AGE"

Pension reforms and their impact

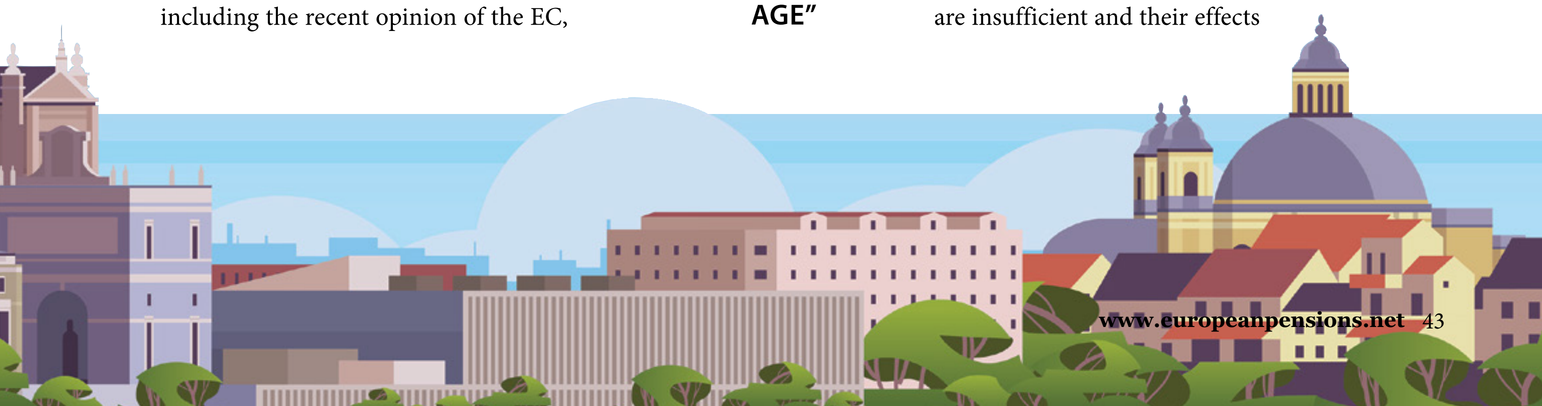
Spain recently underwent a series of public pension reforms that aim to provide greater sustainability to the system. In 2021, price indexation was reintroduced, linking pensions to CPI. "Specifically, it links the annual growth of pensions to the average of the interannual variations of the 12 months prior to December of each year," González explains.

The intergenerational equity mechanism was also introduced to ensure that annual increases in retirement, survivor, and disability benefits continue to be indexed against CPI. From 1 January 2023 to 31 December 2050, employers and employees will pay a special contribution to build up the public reserve fund, starting at 0.5 per cent and 0.1 per cent of eligible earnings respectively, rising gradually to 1 per cent and 0.2 per cent, respectively.

"The EC's report has shown that the 2021-23 reform has increased revenues, but has increased expenditure by a larger amount," notes Doménech, "According to the estimates in the report, the financial needs of the public pension system last year were equivalent to 4 percentage points of GDP. This will increase to 5.7 percentage points by 2050."

Jiménez adds: "Maintaining the level of pensions by increasing it through CPI is desirable and contributes to the adequacy of the system, but it has a high cumulative cost that is not offset by other measures on the expenses side.

"Early retirement and late retirement reforms have been undertaken to delay the effective retirement age. Although they are going in the right direction, they are insufficient and their effects



will be very limited. It's almost sure that the access to early and partial retirement will suffer another reform in the following months.

"The latest reforms are all aimed at increasing the income of the system but, sadly, not in the necessary quantity."

Villanueva states that the balance of the reforms appears to be in deficit, as the additional revenue measures did not seem to alleviate the increase in expenditure.

"Incentives to prolong working life do not seem to be an important counterbalance to this increase in spending either," he says. "On the revenue side, moreover, it is highly dependent on the evolution of GDP and employment, and therefore on contributions and revenue for the system."

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The case for further reform

While some are sceptical about the effectiveness of the 2021-23 reforms, there are several ways in which future reforms could ensure the sustainability of public pensions in Spain. The agreement between the government and the EC gives the government the opportunity to propose measures to tackle the pension spending gap after the AIREF's assessment next year, or automatically increase social security contributions, if there is a shortfall.

There are several other measures that could reduce expenditure, and Doménech states that following best practice observed in other European countries could be a way forward. "A combination of either an increase in the retirement age with life expectancy, and if you want to retire earlier to pay a cost in terms of your initial pension," he says.

"There are other measures, such as taking into account the whole working career and contributions. For us, and this is something we have been proposing for the past 10-15 years, we think a system like the national account systems we have in Sweden, Estonia, and other European countries is not only the most sustainable, but also the most transparent and efficient system.

"Then we could introduce additional financial restrictions to ensure the system is sustainable, for example in the Swedish pension system they have a clause condition in case there is a financial imbalance in the system; pensions every year will be conditioned on the imbalance in the system."

The sustainability of the public pension system has also brought the need for private and workplace pension savings into the spotlight. "The Spanish government is working on a law to promote occupational pension plans to encourage savings through companies, a concept that has not been extensively developed in Spain to date, with the aim of facilitating savings to supplement public retirement through the second pillar of social welfare (savings in occupational plans)," says an Aegon Group spokesperson.

Jiménez also points to the government's plans to develop the workplace pension system, including promoting its inclusion in the framework of sectoral collective bargaining and including measures to make it more flexible, attractive, and easy to implement and manage. "Hopefully, we can see an increase in this type of system in the following years in Spain, and a change in the Spanish savings culture, to have a solid and growing market of complementary pensions in Spain," he says.

Villanueva concludes that while recent reforms are a "step in the right direction" to face the immediate challenges, more profound interventions are needed to guarantee the long-term sustainability of the Spanish public pension system.