

Reforming the pension system: in search of sustainability

Spain is entering an historic moment: the first batches of baby boomers are beginning to retire in 2023 and will continue to do so over the next 17 years.¹ Considering that in the coming decades the population over the age of 66 will gain prominence while that of the working-age population will diminish, it is of vital importance to evaluate the sustainability challenge facing our public pension system following the latest reform – a task which has been addressed by various agencies and which we analyse in this article.

According to the demographic projections produced by the National Statistics Institute, between 2023 and 2050 the working-age population in Spain will decrease by more than 800,000 people,² while the population over 65 will increase by more than 6 million. Thus, by 2030, almost 4 million baby boomers will already be enjoying their thoroughly deserved retirement, and this figure will exceed 11 million by 2040. Given that the Spanish public pension system is a redistribution system in which today's contributors pay the pensions of today's retirees in exchange for receiving a pension in the future based on their present contributions, it is worth asking how the increase in the relative weight of the senior population will affect the system's sustainability and what measures are being taken to balance it out. Wide-ranging estimates have been made regarding the impact of the pension reform on the long-term Social Security deficit, after the second part of the reform was approved in March. In this article, we will focus on the analyses carried out by the Independent Authority of Fiscal Responsibility (AIReF),³ the European Commission in its *2021 Ageing Report (AR21)* and the Ministry of Inclusion, Social Security and Migration (MISMM).

In 2022, the Social Security deficit stood at 0.5% of GDP,⁴ with expenditure on contributory pensions amounting to 12.0% of GDP.⁵ The AIReF estimates that contributory pension spending will increase by 2.8 pps between 2022 and 2050, bringing it to 14.8% of GDP, due to the high cost of the indexation of pensions to inflation (+2.7 pps), the repeal of the sustainability factor (+0.8 pps)⁶ and the inertia of demography, the labour market, etc. (+0.4 pps). On the other hand, these factors will be partially offset by expenditure savings (–1.2 pps), which will come mainly (–0.8 pps) from people taking later retirement because of the new monetary incentives. The AR21 gives very similar estimates of the impact of indexing pensions to inflation and repealing the sustainability factor, but it estimates that the inertia of demographics, the labour market, etc. will add 0.7 pps (rather than 0.4 pps) to expenditure in terms of GDP.

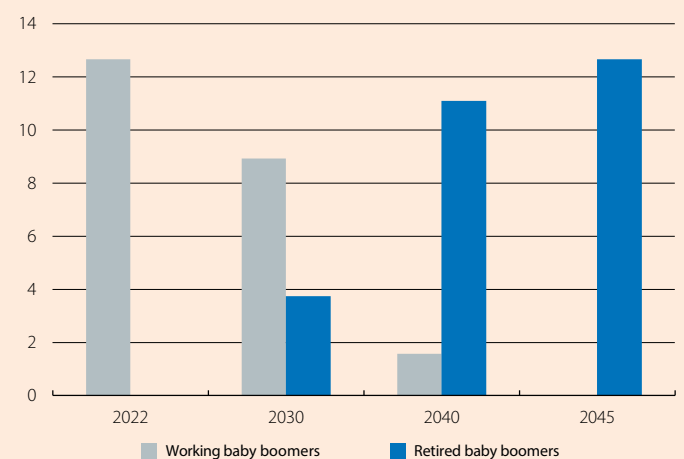
The second part of the government reform has introduced measures focused on boosting revenues, the bulk of which comes from the gradual increase in social security contributions. The burden of this increase in contributions will fall mainly on those with high incomes, while the highest pensions will not grow at the same rate.⁷ According to the AIReF, revenues will increase by 1.3 pps of GDP by 2050, which is less than the 2.8-pp increase in expenditure. Of these 1.3 pps, 0.8 points are expected to come from the aforementioned increase in social security contributions and 0.5 points from the new social security contribution scheme for self-employed workers.

The MISMM, meanwhile, has a more optimistic projection: contributory pension spending is expected to increase by around 1.5 pps of GDP to approximately 13.5% of GDP by 2050, some 1.3 pps less than according to the AIReF projections.⁸ In particular, the indexation of pensions to inflation and the improvement of minimum pensions, the repeal of the sustainability factor and the inertias are expected to increase expenditure by almost 3 pps of GDP, but delayed retirements will also enable savings of 1.5 pps of GDP. On the revenue side, they project an improvement of 1.5 pps in terms of GDP by 2050.⁹ This increase in revenues is very similar to the increase in expenditure, so the deficit would not increase.

One of the two main factors that explains the differences between these various projections is the underlying macroeconomic scenario: that of the MISMM is more optimistic, with an average annual real GDP growth of 1.9% in the period 2023-2050. This is 0.6 pps higher than

Spain: baby boomers

(Millions of people)



Source: CaixaBank Research, based on the National Statistics Institute's demographic databases.

1. It should be recalled that baby boomers are defined as the cohorts born between 1958 and 1975.

2. Refers to the population between 16 and 64 years of age. This is a much smaller drop than according to the latest demographic projections by the AIReF, which places the reduction at over 3 million. The main reason for the difference is that the National Statistics Institute projects net annual migration flows of more than 300,000 people over the period 2023-2050, while the AIReF anticipates a lower figure of 229,000.

3. See AIReF. «Opinión sobre la sostenibilidad de las administraciones públicas a largo plazo: la incidencia de la demografía», Opinión 1/23 (content available in Spanish).

4. The same figure that is expected in 2023 according to the General Government Budget.

5. 13.5% of GDP if we include the so-called passive-class pensions (for civil servants) and non-contributory pensions (for disability, widowhood, etc.).

6. This mechanism automatically linked the increase in pensions to life expectancy, which ensured the balance of the Social Security accounts in the long term. However, it entailed a cut in the initial pension ranging from 2% for a person aged 60 today to 10% for a person aged 25 today.

7. According to the AIReF, the bulk of the increase in social security contribution will fall on those with earnings of over 54,000 euros (65% of the cost of the reform), mainly due to the increase in the maximum contribution bases.

8. See slide 18 of the report entitled [Informe sobre la modernización del sistema de pensiones](#) by the Ministry of Inclusion, Social Security and Migration (MISMM) of March 2023 (content available in Spanish).

9. 1.1 pps due to the increase in social security contributions and 0.4 pps due to the new scheme for self-employed workers.

that of the AIReF and 0.4 pps higher than in the case of the AR21, as it incorporates a long-lasting and substantial impact on potential growth of the reforms and investments under the NGEU Recovery Plan. This higher economic growth is fed¹⁰ by an average labour productivity growth in 2023-2050 of 1.5% (0.4 pps more than the AIReF and 0.1 pp more than in the AR21), net annual migration flows of 308,000 people in 2023-2050 (compared to 229,000 according to the AIReF and 182,000 in the AR21), a reduction in the unemployment rate to 5.5% in 2050 (compared to 7% in the AIReF and 7% in the AR21)¹¹ and a participation rate of the population aged between 20 and 64 of 84% in 2050 (82% in the AR21).¹² These differences in the macroeconomic and demographic assumptions have a substantial impact on the anticipated expenditure as a percentage of GDP. Specifically, the macroeconomic scenario according to the MISMM is relatively similar to an alternative, more optimistic scenario presented by the AIReF in which it considers average GDP growth of 1.6% in 2023-2050, an unemployment rate converging towards 5.0% by 2050 and net annual migration flows of 271,000 people. In this alternative AIReF scenario, pension spending in 2050 would be 1.3 points lower than in its baseline scenario; that is, spending would grow by just 1.5 pps, an increase very similar to that of revenues (+1.3 pps).

The second factor to consider is the impact of the monetary incentives for delaying retirement:¹³ according to the AIReF, these incentives will give rise to savings in pension spending of 0.8% of GDP in 2050, because 30% of workers will delay retirement by three years or until they turn 68.¹⁴ In contrast, the MISMM estimates that these incentives will result in spending savings of 1.5% of GDP in 2050, which would mean that 55% of workers would delay retirement by three years or retire at age 68.

Due to the high degree of uncertainty surrounding how the country's macroeconomic situation will evolve over the next 30 years, the reform establishes that the AIReF will review its impact every three years beginning in 2025. Moreover, it establishes that measures will

Spain: macroeconomic assumptions underlying the pension spending projections

	MISMM	AIReF	Ageing Report 2021
Real GDP growth 2023-2050	1.9%	1.3%	1.5%
Productivity growth per hour worked 2023-2050	1.5%	1.1%	1.4%
Employment growth (hours) 2023-2050	0.4%	0.2%	0.1%
Net migration flows 2023-2050	308,000	229,000	182,000
Participation rate 2050 *	84.0%	68.4%	82.0%
Unemployment rate 2050 **	5.5%	7.0%	7.0%

Notes: * The participation rate according to AIReF is not comparable with that of the Ministry of Inclusion, Social Security and Migration (MISMM) or the AR21, given that it corresponds to people between 15 and 74 years of age, whereas those of the MISMM and the AR21 are for people aged 20 to 64. ** The unemployment rate per the AIReF corresponds to people aged between 15 and 74, that of the AR21 between 20 and 64, while in the case of the MISMM the age range is not specified. **Source:** CaixaBank Research, based on estimates from the MISMM, AIReF, the 2021 Ageing Report and Fedea.

scenario materialises. For this to be the case, it will be key to boost productivity through reforms linked to the NGEU programme and to illuminate a greener and more digital economy that allows a buoyant and sustained level of potential growth to be achieved.

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10. The assumptions regarding migration flows, the unemployment rate and the participation rate according to the MISMM have been set out in A. De la Fuente. «Los efectos presupuestarios de la reforma de pensiones de 2021-23: iii) impacto total y cláusula de salvaguarda del MEI» Estudios sobre la Economía Española, 23/13, Fedea (content available in Spanish).

11. In reality, these figures are not entirely comparable: the unemployment rate per AIReF corresponds to people aged between 15 and 74, that of the AR21 between 20 and 64 years, while in the case of the MISMM the age range is not specified, although presumably it is for the age range between 20 and 64 as well.

12. The participation rate is the labour force (employed and unemployed) over the total population. The AIReF estimate is not comparable, as it gives the participation rate for the population between 15 and 74 years of age.

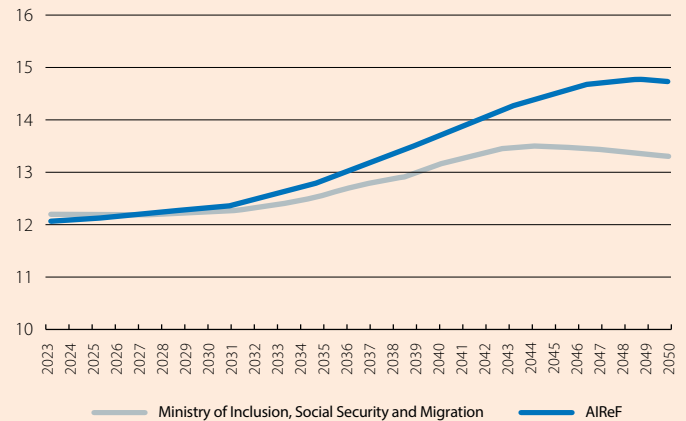
13. A 4% pension increase for every extra year worked above retirement age or, as an alternative to the 4% increase, a fixed lump-sum upon retirement (e.g. maximum pension and over 44.5 years paying social security contributions: 12,060 euros for each extra year). Both formulas can be combined.

14. 68 is the new minimum age to allow forced retirement under a collective labour agreement. Currently, only 5.4% of Spanish workers take late retirement.

15. Including both passive-class and non-contributory pensions, both financed by the General Government Budget.

16. See its 2022 Annual Report published in May 2023.

Spain: projections for expenditure on contributory pensions * (% of GDP)



Notes: * These expenditures already take into account savings from delayed retirement incentives. They exclude expenditure on so-called passive-class pensions for civil servants, which would amount to approximately 1 additional percentage point of GDP over the period, as well as expenditure on non-contributory pensions, which would amount to an additional 0.2-0.3 points.

Source: CaixaBank Research, based on the charts by the Toledo Pact Commission and the AIReF.