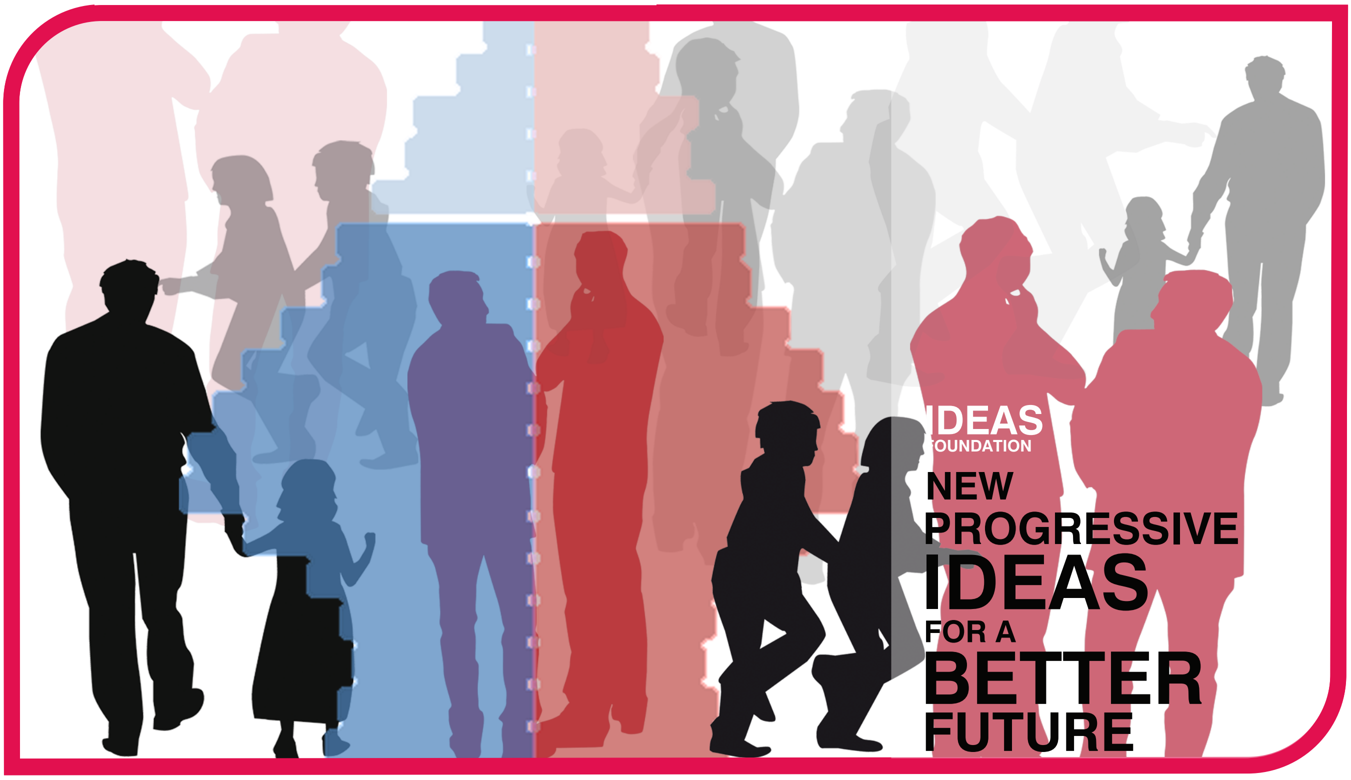
PENSION SYSTEM REFORM

HOW WILL SPANISH SOCIETY BENEFIT?

REPORT · FEBRUARY 2011



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Executive Summary

- The reform of the pension system negotiated by the Spanish Government with the social agents, in a process culminating in the agreement reached in January 2011, was not born out of the current economic crisis. It is rather based on three long-term structural changes which already needed to be dealt with before the recession: a downturn in birth rates, greater life expectancy and an increase in the purchasing power of pensions.

- Even before the current economic crisis broke, the demographics of Spanish society meant that the country was faced with the need to transform the system. The impact of the crisis has simply served to highlight the urgency of approving this reform. The truth is that, even had the crisis not occurred, the system would have only gained an extra year before the system registered a deficit, in 2025. What we confronted were major structural, rather than cyclical, challenges, which is why the 2011 reform had to be introduced without delay.

- The agreed reform sends out a clear message that Spain will be readjusting its long-term public accounts. While the reform is just as rigorous and sustainable as those implemented in France and Germany, it also includes an agreement with social agents. Something which did not prove possible in those neighbouring countries, and this makes Spain the leading example in Europe in this regard.

- Over the last ninety years (since 1919), the system has dealt with the needs of 22.5 million people. In just 30 years, however, it will be called on to cover a further 22.5 million, and they will be living an average of four years longer.

- Within this context, the 2011 reform will introduce significant changes to maintain the sustainability of Spain's pension system, as occurred previously in the reforms introduced in 1985, 1997 and 2006.

- Practically all elderly people in Spain (some eight million) currently receive a pension amounting on average to 800 euros per month. The difference between the maximum and minimum pension amounts to barely a factor of 3.5, making the Spanish pension system one of the most equitable in the world.

- This pension system, which is in good financial health and serves to guarantee the pensions of the current generation of elderly people, requires a renewed collective effort in order to guarantee that in 30-40 years it will still be functioning properly and be self-sustaining in order to pay future pensions without the need to draw on resources from outside the distribution system itself.

- According to the estimates made in this study, if changes had not been made to the system the emergence in the medium term of a structural imbalance between revenue and expenditure would have made maintenance of the purchasing power of pensions unsustainable. The Social Security Reserve Fund *(Fondo de Reserva de la Seguridad Social)* would have been unable to maintain the level of pensions for more than ten years after the deficit emerged in the system (in 2014). Without the contribution of additional resources, by 2050 the average pension would have dropped to 515 euros (in 2010 purchasing power terms), a reduction of 35% in terms of spending power.

- In order to avoid this future devaluation of pensions, the 2011 reform modifies two fundamental parameters in terms of how the system operates: the age of retirement, which is gradually being increased to 67 years, and the period of contributions in order to generate entitlement to a pension, progressively increased from 15 to 25 years.

- The concern that an increase in the period of contributions employed in calculating pensions will lead to a reduction in real terms is unfounded. This concern was also voiced in the public debate prior to the pension system reforms of 1985 and 1997, whereas it was subsequently seen that the changes, in fact, served to increase the purchasing power of pensions, just as will occur with the current reform. The key to improving pensions lies in a more performing economy, which will generate an overall increase in productivity, and hence in the real salaries used as the benchmark for calculating pensions.

- According to the calculations made in this study, the reform will guarantee better pensions in the future. On a scenario of modest macroeconomic growth of 1.5% over the coming decades, the pension system will be able to operate at a surplus following the reform until 2030 and beyond. This will serve gradually to increase the Reserve Fund, thereby guaranteeing a self-sustainable system until 2045, while also increasing the value of pensions. According to this scenario, by 2050 the average pension could be 915 euros (in 2010 purchasing terms). That means an increase of 17% compared with the current average pension (of 800 euros).

- In order to ensure that pensions can continue to improve, the key factor is an increase in productivity, tied to a sustainable economy. On a scenario in which we jointly consider the reform of the pension system and the transformation of the productive model (thanks to the set of structural reforms being passed, and the efforts made by companies and across society to bring about a change in the fundamentals of our economy), we find that by 2050 the average pension could amount to 1,125 euros (an increase of 44% compared with the current average pension).

- In order to achieve this outcome we would need a significant increase in productivity over the coming decades, thereby restoring a pattern of growth of around 3%. However, so as to guarantee that our level of economic and social well-being will continue to rise at this pace, there will also be the need for growth in employment and additional manpower, giving the Spanish economy an employed population of some 21 million workers by 2050.

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