MINISTERIO
DE ECONOMÍA Y
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REFORM OF THE SPANISH PENSION SYSTEM

The Government approved on January 28th, 2011, a draft Bill on Social Security Reform. The Bill contains a set of measures aimed at strengthening the future sustainability of the Spanish pension system, following the recommendations issued by the Congress on January 25th. The reform also has the support of the main Labour Unions and business organizations. The main components of the reform are the following.

According to our estimates, the reform will imply savings for the pension system of around 3.5% of GDP in 2050 (2.8% in 2040 and 1.4% in 2030).

This reform must now be approved by the Parliament.

1. MAIN LINES OF THE REFORM

GENERAL RULES

Legal retirement age. The legal retirement age will increase from 65 to 67 (through a gradual increase from 2013 to 2027).

Pension benefits.

- The earnings record taken into account to determine full pension benefits will be gradually lengthened from 15 years to 25 years.
- The number of years of contributions required to obtain full pension benefits will gradually increase from 35 to 37 – calculations will be made on the basis of monthly contributions, rather than rounding to the next full year, as was the case prior to the reform.

  The percentage of the full pension received by a worker will be proportional to the number of years contributed, starting at 50% for careers of 15 years up to 100% for careers of 37 years. By comparison, before the reform, the system was biased in favour of shorter careers.

The reform allows for **certain exceptions** to these rules:

- Long contributing careers: Workers having contributed at least 38.5 years will be allowed to retire at the age of 65 with full pension benefits.
  - *Mothers having interrupted their contributing career due to child bearing*: Their cumulative period of contribution will be increased to account for the interruption in their careers related to having children. It will be increased by the duration of the period of interruption (up to a maximum of 9 months per child and 24 months per family) as long as they meet certain requirements regarding contributions to the system.

- Professionals in dangerous occupations: Workers performing work that is of an especially dangerous or arduous nature may be allowed to retire before the age of 67.

Early, partial and delayed retirement: The possibility of early retirement is delayed from 61 to 63 years. Eligibility for early retirement is limited, since it will only be possible after 33 years of contribution to the pension system (versus 30 prior to the reform). Penalization applied to pension benefits will be 7.5% per year of early retirement (prior to the reform, penalization depended on the years of contribution from 7.5% to 6% for long careers where early pensions were concentrated); the resulting pension cannot be lower than 125% of the minimum pension. There is one exception to the 63 rule - early retirement during an economic crisis. In that case, workers will be allowed to retire at 61, provided that they contributed for at least 33 years. The reform removes the possibility of a special retirement modality at 64.

Partial retirement at age 61 will continue to be permitted, although with the new reform both the new and the partially retired employee will contribute fully to the system. Prior to the reform, the worker partially retiring only contributed by the proportion of the working day effectively worked.

Finally, voluntary extension of working life is encouraged through increased bonuses depending on contributing careers, 2%, 2.75%, and 4% per year of delay for careers below 25 years, between 25 and 37, and over 37, respectively.

Sustainability factor

Beginning in 2027, the parameters of the system will be revised every five years by the difference in life expectancy at the age of 67 in the year of the revision and the life expectancy at 67 in 2027. Calculations will be done on the basis of forecasts by official agencies.

The objective of this element is to ensure the long-term sustainability of the public pension system and maintaining the proportionality between contributions to the system and the benefits it is expected to payout.

Youth training

The text of the future law takes into account the fact that more young people are entering into the workforce through training and research programs that in some cases involve no contribution to the System. After the reform, companies that finance these training or research programs will have to contribute to Social Security beneficiaries, in similar terms to training contracts.

Improvement of minimum pension benefits for individuals

The approved text reinforces the protective action of the system with improved minimum pension benefits for elderly pensioners living alone, whether it is the retirement, disability, or widowers' pension.

Supplemental payments to minimum pension in the contributory system will be capped by the non-contributory pension.

2. ECONOMIC IMPACT OF THE REFORM

According to our estimates, the reform will imply savings for the pension system of around 3.5% of GDP in 2050 (2.8% in 2040 and 1.4% in 2030). These savings will be mainly a result of:

- The increase in the activity rate of the population between 16 and 71 years old and higher potential GDP level.
- The increase in the earnings record from 15 years to 25 years.
- The enlargement of the years to obtain full pension benefits, from 35 to 37.
- The sustainability factor
- It is important to recall that these estimates do not include the extension of the social security reform to the central government employees' pension system.

The extension in the statutory, minimum and early retirement ages, including the exceptions, will increase the activity rate of the population between 16 and 71 years old by 1.5-2 percentage points after the transitory period. Around 50% of new pensioners have contributing careers longer than 38.5 years, and the socio-demographic trends imply a lower share of the population in that situation in the future). The increase in the retirement age will save the Social Security system, in the long run, around 1 percentage point of GDP, including the changes in early retirement schemes and the increase in the contributions of partial retirement. Besides, the increase in activity rates implies that potential GDP will be 1.4%-1.7% higher than in the absence of the pension reform. On its own, this new level of GDP will imply that the ratio of public pension expenditure over GDP will be 0.2 percentage points lower in the long run (see Table 1).

Similar savings are obtained from increasing the number of years considered to calculate full pension benefits from the last 15 years to the last 25 years. Notice that maximum wages in Spain are recorded at the ages of 55-59, and the wage slope before that age is quite steep. In particular, previous studies of returns to experience in Spain according to the Structural wage survey reflect an increase around 4% for ages before 55-59. A less generous computation of non contributing months during the period considered for the calculation, together with the cap for supplemental payments to minimum pensions, are also taken into account.

The enlargement of the number of years required to obtain full pension benefits, from 35 to 37, and the linear monthly scale, will imply a savings of 0.3 percentage points.

Finally, the impact of the sustainability factor has been calculated assuming that similar elements to those modified in this reform are changed according to the evolution of life expectancy from 2032. This implies, savings of around 1 percentage point of GDP using National Statistics Institute life expectancy projections from 2010.

It is important to recall that these estimates do not include the extension of the social security reform to the central government employees' pension system.

All together, this reform will put pension expenditure relative to GDP in Spain below those projected for the largest euro area countries.

THE IMPACT OF THE REFORM
SAVINGS OF THE SOCIAL SECURITY SYSTEM
% over GDP

Year	Higher potential GDP	Statutory retirement age	Years considered to calculate the pension	Years needed to qualify for full pension	Sustainability factor	TOTAL
2030	0,1	0,8	0,4	0,1	0,0	1,4
2040	0,2	1,0	0,8	0,3	0,5	2,8
2050	0,2	1,0	1,0	0,3	1,0	3,5

Source: Ministerio de Economía y Hacienda