PENSION SYSTEM REFORMS IN TIMES OF AUSTERITY IN THE EUROPEAN UNION: THE SPANISH CASE

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This paper examines the impact that the economic crisis has had on pension systems and how it has influenced the development of pension policies in the European Union, and particularly in Spain. It is divided into two parts. The first one focuses on the main challenges currently faced by pension systems in Europe –the threat of ageing populations and its implications for the long-term sustainability of public finances– and the process of pension reform that originally started a long decade ago, and that has in recent years gained intensity due to the economic crisis. The second part specifically deals with the latest pension reform trajectory in Spain critically examined from a legal and constitutional perspective.

I. PENSION SYSTEMS IN THE EUROPEAN UNION: CHALLENGES AND REFORMS

A. PRELIMINARY REMARKS

Before analyzing the challenges that European pension systems are facing and the reform trajectory followed by the EU-member states since the turn of the century, it is necessary to make some general remarks.

First of all, it must be emphasized that there is not solely one European pension model; on the contrary, as NATALI and STAMATI have pointed out, the

European Union still contains a great variety of pension models and traditions[1]. Nevertheless there are three common features of great significance to be taken into account. On the one hand, pension spending represents the main expenditure item of State Budgets: in terms of ratio on GDP it stands at an average level of 11.3 (% of GDP) in the EU-28[2]. On the other hand, despite the efforts made to foster private funded pension plans in recent years, public pension systems financed on a pay-as-you-go basis still play a prominent role. Finally, the most relevant demographic trend affecting all European societies is ageing: the age structure of the Member States' populations will profoundly change as the retirement of the baby-boom generation gains intensity and the average life expectancy continues to rise. This will no doubt put upward pressure on public spending demanding structural reforms to guarantee sustainability.

Secondly, as far as this process of reforms is concerned, it must be acknowledge that the response of national policymakers have been particularly intense in the 'bailed-out' countries (Spain included). But we should not overlook that this reforming trend is widely shared by all Member States –in some cases initiatives were launched well before the onset of the economic crisis– as it is very closely related to the ageing phenomenon and the provision of retirement income.

Lastly, a third remark (warning) refers to the importance of bearing in mind the different consequences with pension system sustainability considering the two relevant issues from the perspective of time. Thus, the critical juncture associated with economic crisis and fiscal consolidation policy is determinant in the short run; whereas structural challenges stem from demographic change

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[1] *Reforming pensions in Europe: a comparative country analysis*, ETUI, Working Paper 2013.08, p. 7. These two authors use two suggestive criteria to characterize each pension system: one, their basic architecture, distinguishing 'multi-pillar' and 'social insurance' systems; and, two, their development pattern, so that we might refer to 'first and second generation' pension models. See also the taxonomy of main pension schemes in: EUROPEAN COMMISSION, *The 2015 Ageing Report. Economic and budgetary projections for the 28 EU Member States (2013-2060)*, European Economy 3/2015, pp. 54-55.

[2] *2015 Ageing Report, op. cit.*, p. 247.

and its projection on public expenditure must be assessed in long-term prospects.

B. CHALLENGES: AGEING POPULATIONS AND ECONOMIC CRISIS

Understanding the purposes and assessing the contents of recent pension legal reforms demand a previous critical thought on the current and future challenges –the afore mentioned ageing population and economic crisis– faced by public pension systems in the European Union.

The first main challenge is the demographic change that will be transforming the population structure over the next decades: every Member State –in a higher or lower level– is moving towards an ageing society, i.e. a society where the proportion of older persons increases while that of younger persons decreases. Not surprisingly, such a demographic structure has very important implications for the long-term sustainability of public finances. Leaving aside labour force projections and other demographic determinants[3], two main factors are to be mentioned as key facts that there will be a significant increase of people aged 65 or above.

On the one side, projections assume that life expectancy –both at birth and at age 65– will keep its upward trend, so that in 2060 65-years-old male pensioners will expect to reach the age of 87.4 (82.6 in 2013) and the female ones the age of 90.6 (86 in 2013). This increase of up to 4.8 and 4.6 years, respectively, implies a potential significant growth of public pension spending due to the extension of retirement period. But surely even more relevant than that in terms of expenditure is, on the other side, the upcoming retirement of the

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[3] Attention must be drawn to two additional factors (see: *The 2015 Ageing report, op. cit.*, p. 14, 16). The first one is fertility rate that stagnantly stands bellow the natural replacement level (2,1). Although a gradual increase is projected for the upcoming years, the current 1,59 rate (2013) will just go up to 1,76 in 2060. The second factor corresponds to net migration flows. The projection assumes that the cumulated net migration to the European Union over the period 2013-2060 will represent an 11% of the current population (55 million people), a continued but decelerating inward net migration. But, on top of the differences across the Member States, it is a highly uncertain factor due to its political dimension and the reliance on the state of the labour market.

baby-boom generation. As the largest cohort ever, those persons aged 65 and over will become a substantially larger share: the proportion of old people will rise from the current 18,4% to 28,4% in 2060.

This two-fold factor, along with the stagnation of the working age population, decisively contributes to the increase of the old-age dependency ratio (it goes up from 27,8% to 50,1% in 2060) threatening the balance of pension systems based on intergenerational equity. In 2013 there were four working-age people for each person aged 65 and over – it is important to point out not necessarily active workers–. Now, the demographic change towards an ageing population would entail that in fifty years time that proportion would be diminished to just two working-age persons for every elder[4].

This new scenery reflects on public pension expenditure level. According to *The 2012 Ageing Report*[5], the average pension spending increased two percentage points of GDP, from 12,2% in 2010 to a significant 14,1% in 2060 in the Euro Area (11,3% and 12,9%, respectively, on avarage for the whole EU). Notwithstanding that such a figure is certainly high and, in a sense, could question the long-term sustainability of public pension systems, it should be underlined that some important countries spent at the time mentioned –and still do– an even greater percentage more than that (France 14,6%, Italy 15,3%). However an unexpected circumstance came up influencing the terms of the debate: the onset of economic crisis.

The adverse economic context would intensify pressure on Member States in favour of legal reforms to give a response to the mentioned structural challenge. The financial tensions suffered by pension systems across Europe mainly due to a (sharp) loss of jobs and the correlative drop of contributions was seen as a

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[4] Regarding the total age dependency ratio –a formula that shows the proportion of people aged bellow 20 and above 64 over the population aged 20-64–, the trend projection is very similar to the one just refered: it will increase from 64,9% in 2013 to 94,5% in 2060. [All data are taken from the *2015 Ageing Report*: 20-24].

[5] Things have changed in the meantime as a consequence of the legal reforms implemented in the last three years. Projections estimated in *The 2015 Ageing Report* are significantly lower, as we will see.

forewarning of the sustainability problems that public pension schemes would have to face in a future aged society. With that said, the economic crisis and the process of fiscal consolidation initiated in 2010 to overcome it, became a new challenge for pension systems. In other words, from that point onwards pensions –as a salient item of public spending– became part of the *'austerian'*[6] strategy: sovereign debt crisis and the economic slowdown curtailed the resources needed to keep the public pension budget in balance, eventually putting *pensions under stress*[7].

It cannot be denied that those two challenges (economic crisis-austerity and an ageing population) are very closely related. But we should insist that their time dimension is well different. Generally speaking the process of fiscal consolidation did not have to rely on a sudden cutback in pension spending. In the short run, there were alternative finance mechanisms to cope with the recession and the job loss (for example, the Reserve Pension Fund in Spain). Structural reforms on pensions were not so urgent as no serious imbalance was at that point clearly evident.

Nevertheless, the context of critical urgency has been used to implement reforms that go far beyond that which is strictly needed, at least for the moment. In general terms, policymakers have typically tightened eligibility conditions and reduced the generosity of benefits and indexation mechanisms. But those initiatives have been much more intense in bailed-out countries (Spain included) given the fact that a key element of the memorandum of understanding subscribed was precisely a less generous pension systems[8]. As we will see, those setbacks eventually imply a model shift.

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[6] See: Krugman, P. *End This Depression Now!,* Norton, 2012, p. 193.

[7] See under that title the Editorial to OECD, *Pension at a Glance 2013: OECD and G20 Indicators*, OECD Publishing, 2013, p. 9-11.

[8] See the very interesting studies by the EUROPEAN PARLIAMENT (Directorate General for Internal Policies) requested by the Committee on Civil Liberties, Justice and Home Affairs: *The impact of the crisis on fundamental rights across Member States of the EU - Country report on Greece* (PE 510.014, pp. 87-104), *on Portugal* (PE 510.020, pp. 41-43), on Ireland (PE 510.016, pp. 49-55), on *Spain* (PE 510.019, pp. 54-60), on *Italy* (PE 510.018, pp. 59-65), on *Cyprus* (PE 510.017, pp. 43-45) and *on Belgium* (PE 510.015, pp. 40-44). See also:

C. A LONG DECADE OF PENSION REFORM IN THE EUROPEAN UNION

Since the turn of the century, all Member States have carried out reforms in their pension systems. Despite each country's traditions and peculiarities, some features are common to this reform trajectory.

Regarding the political and socioeconomic context, we have already mentioned two determinant issues: ageing and austerity. But there is a third factor to bear in mind: the strong influence of the financial sector –among others–, very much interested in developing prefunded pension schemes and, as a corollary, in limiting the size of public pension systems as an effective way of fostering those private mechanisms.

As far as the content of this reform process is concerned, the analysis makes it possible to present some guidelines that inspire in a certain way most of the legal initiatives implemented throughout this period. They are outlined in a document of reference: the European Commission's *White paper - An Agenda for Adequate, Safe and Sustainable Pensions*[9]. Leaving aside that it is dated in 2012[10], the relevance of this paper lies on its aim to fix a global strategy for adapting pension systems to new economic and demographic circumstances in order to guarantee *sustainable and adequate*[11] pensions in the long run. Specifically two major trends of reforms are signaled to progressively

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PETMESIDOU, M. – GLATZER, M. "The crisis imperative, reform dynamics and rescaling in Greece and Portugal", *European Journal of Social Security*, volume 17 (2015), No. 2, pp. 166-168.

[9] COM/2012/055 final

[10] It actually has a precedent in a Green paper on the same topic from 2010: *Towards adequate, sustainable and safe European pension systems* [COM(2010)365 final]. Both initiatives are rooted in the three-pronged strategy to face ageing population adopted by Stockholm European Council in 2001 that comprised reforming social security systems alongside with public debt reduction, and increasing employment and productivity.

[11] Sustainability and adequacy is the motto, though the reform's priorities are clearly biased towards the former as we will see (NATALI, D. *Reforming pensions…, op. cit.*, p. 20).

strengthen the shift towards multi-pillar pension systems (or its consolidation when such pattern already existed) since the beginning of the century[12].

The first one corresponds to the purpose in balancing the time spent in work and retirement. As a response to the increase of life expectancy, the *White paper* underlines the importance of reinforcing contributory principles in order to counterbalance the burden that those extra years in retirement bring about in terms of spending. Apart from recognizing the importance of fully activating the EU's labour potential[13], the goal results in (potentially) controversial parametric measures as those directed to increase contribution periods for drawing a full pension and, more significantly, to raise pension eligibility,restricting access to early retirement and raising statutory pensionable age. Furthermore, given the uncertainty associated to such demographic changes, new types of automatic adjustment mechanisms are additionally introduced as a guarantee to financial sustainability[14].

The second major trend has to do with developing complementary private retirement savings[15]. It is to be noted that the sorts of measures prompted go far beyond parametric changes as they are to affect the global structure of (public and private) pension system; therefore we might refer to them as systemic reforms. However it is true that no radical actions –such as compulsory enrolment in private pension plans– are planned so far, perhaps influenced by the vulnerability showed by this type of instruments in a context of

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[12] See the very illustrative document by the EUROPEAN COMMISSION: *Progress and key challenges in the delivery of adequate and sustainable pensions in Europe [a Joint Report on Pensions* by the Economic Policy Committee (Ageing Working Group), the Social Protection Committee (Indicators Sub-Group) and the Commission services (DG for Economic and Financial Affairs and DG Employment, Social Affairs and Equal Opportunities)], *Occasional Papers* 71, November 2010.

[13] From that perspective, it insists on reaching higher employment rates (older people, youth, women, migrants) and guaranteeing better quality of employment (working conditions, lifelong learning and more effective training).

[14] See in a comparative perspective: BOSWORTH, B. P. — WEAVER, R. K. "Social Security on Auto-Pilot: International Experience with Automatic Stabilizer Mechanisms", *Center for Retirement Research at Boston College Working Paper*, nº 18, 2011, pp. 1-43.

[15] See *White paper (op. cit.*, pp. 12-13).

crisis[16]. As a matter of fact, emphasis is made on improving the legal frame to offer better cost-effectiveness, safety and equitable access to supplementary pension schemes, likewise guaranteeing these private pension entitlements across borders.

It is probably too soon to make an assessment of the extent to which such major trends have already been implemented. Nevertheless there is a (provisional) conclusion that can be drawn. The comparison of gross public pension expenditure levels in the 2012 and 2015 projection rounds contained in the last two European Commission's Ageing Reports[17] shows the 'effectiveness' of the legal adjustments made on public pension systems aiming to reinforce contributory principles and their sustainability. The difference between the two pension expenditure projections by 2060 is not minor: -1,1% of GDP on average[18]. Basically, that percentage quantifies the cutback measures adopted by Member States in recent years. Such outcome demands two additional remarks.

Firstly, it should be noted that public pension expenditure is now expected to remain by 2060 at the same level as today (11,2% in the European Union-28 and 12,3% in the Euro area –and 11,3% and 12,3%, respectively in 2013–). That is certainly very relevant in terms of long-term sustainability since it would entail that no further major cutbacks are needed. But it poses the question as to why it was considered to be unsustainable an average spending of 13-14% of GDP regardless each Member State's particularities. The case of Spain is very illustrative in that regard, as we will see below.

Secondly, the *2015 Ageing Report* acknowledges that those pension reforms implemented to strengthen the long-term sustainability lead to sizable

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[16] As for the impact on private pension systems ["a heavy blow (…): losses of nearly 20% of their assets…"] of 2008 financial crisis, see: OECD, *Pension markets in focus*, n. 5, 2008, pp. 3-8.

[17] See: *The 2012 Ageing Report* (p. 101) and *The 2015 Ageing Report* (p. 106).

[18] The difference between a public pension expenditure of 12,3% (2012 Ageing Report) and 11,2% (2015) in the European Union; and 13,4% (2012) and 12,3% (2015) in the Euro Area.

decreases in the projected (public) pension generosity over the coming decades[19]. In particular, two indicators show the magnitude of this cutback that –it is important to stress– varies across the Member States: benefit ratio and the replacement rate at retirement[20]. Both of them are projected to decline around 9 percentage points at the average EU level along the period between 2013 and 2060: the benefit ratio of public pensions will decrease from 44% to 34,9%[21], so that the average public pension benefit would represent little more than a third part of the economy-wide average wage. This would be considered a serious setback in terms of pension adequacy.

We might conclude then that stealthy but determined steps have been taken towards a gradual recalibration of public pension schemes. That is certainly the most effective way of fostering private (prefunded) pension mechanisms. This goal, identified by the White Paper on pensions as a second major guideline, has not yet been achieved. Nonetheless it is probably just a question of time until new pensioners realized that their public pension is significantly smaller than they thought.

II. AUSTERITY AND PENSION REFORMS IN SPAIN

A) THE SPANISH PAY-AS-YOU-GO PENSION SYSTEM AND IT RISKS

Following a consolidated pattern that distinguishes two basic pension models within the European Union –social insurance and multi-pillar–[22], the Spanish

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[19] See *2015 Ageing Report*, *op. cit.*, pp. 90-94.

[20] The *benefit ratio* is technically defined as "… the ratio between the average pension benefit and the economy-wide average wage", whereas the *replacement rate at retirement* represents "… the average first pension as a share of the economy-wide average wage at retirement" (*2015 Ageing Report*, *op. cit.*, p. 91).

[21] With respect to gross average replacement rate at retirement (of public pensions) the projection is even higher as such rate would decline 12,2 percentage points, from 47,5% to 35,3%.

[22] See: BONOLI, G. "Two Worlds of Pension Reform in Western Europe", *Comparative Politics*, Vol. 35, No. 4 (Jul., 2003), pp. 399-402.

public pension system belongs to the *continental social insurance model*. Embedded in the Social Security system (*Seguridad Social*), public pensions in Spain are provided by a double scheme[23]. Firstly, a non-contributory (means-tested), or *nivel no contributivo*, which modestly covers old-age and invalidity [less than 3% of total pension spending] financing pensions through general revenues; and secondly, also primarily, a compulsory social insurance (contributory) scheme, *nivel contributivo* [97%] which provides earnings-related retirement pensions depending on previous contributions and the duration of affiliation. Thus it is a defined benefit pension system based on a pay-as-you-go financing method.

Beyond the specific case, the analysis of the recent development of the Spanish pension system is interesting in so far as it constitutes a good illustration of the two main risks to which pay-as-you-go schemes are exposed[24].

The first weakness (economic risk) has to do with the employment drop caused by the economic crisis in Spain. The dramatic loss of jobs and the correlative reduction of the number of contributors to Social Security –3.5 million between 2008 and 2013– have had a direct impact on its financial condition: a budgetary imbalance (deficit) that exceeds 1% of GDP yearly since 2012. On top of that, the 'internal devaluation' –the reduction in nominal wages to regain labour competitiveness– sought by way of a labour market reform that (too) intensively favours company flexibility, reduces the income's increase associated to job creation in the last two years.

The second, and well-known, weakness of pay-as-you-go pension systems (demographic risk) is also present in this case. Despite the fact that the *baby boom* set off approximately a decade later in Spain than in the rest of Western European countries, the ageing process –aggravated by an endemic low fertility

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[23] Note that private schemes still play a very limited role in pension provision in Spain. Currently private pension plan assests represent 9% of the GDP (*OECD Global Pension Statistics)*.

[24] Extensively on that issue: SUÁREZ CORUJO, B. *El sistema público de pensiones: crisis, reforma y sostenibilidad*, Thomson Reuters-Lex Nova, Valladolid, 2014, pp. 47-85

and a relatively low active population–[25] will have relevant economic, social and political consequences.

To sum up, we could state that both an efficient labour market and a demographic balance are indispensable conditions for a sustainable pay-as-you-go pension system. The Spanish case shows it.

B) THE ECONOMIC AND DEMOGRAPHIC CONTEXT AND ITS PROJECTION ON THE SPANISH PENSION SYSTEM

In the years preceding the economic crisis, the financial condition of the Spanish Social Security was the best of its not so long history. Since the turn of the century, the intense creation of jobs that led to historical levels of active population, coupled with a (temporary) reduced number of pensioners, provided a remarkable budget surplus (1,3% of GDP in 2008). That situation made it possible to combine a (limited) expanding trend in terms of protection –progressive extension of coverage and a gradual increase of minimum pensions– with the creation of a Social Security Reserve Fund nourished by a great part of those surpluses[26]. By the same token, the level of public pensions in retirement relative to earnings when working (replacement rate) was one of the highest across the OECD countries[27] despite the adequacy problems still remaining, especially those that affected women in terms of ´at-risk-of-poverty' rates, low replacement rates and insufficient coverage[28]. During this time population ageing was seen as a medium and long term challenge that could be

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[25] See: INSTITUTO NACIONAL DE ESTADÍSTICA, *Living Conditions Survey 2014* (May 2015).

[26] See the Reserve Fund allocations approved by the Council of Ministers (according to sections 1, 2 and 3 *Act 28/2003 of 29 September, regulating the Social Security Reserve Fund*) from 2000 to 2010 –there have been no allocations since then– in: SECRETARIAT OF STATE FOR SOCIAL SECURITY, *Report to Parliament. Social Security Reserve Fund*, p. 2 (http://www.seg-social.es/prdi00/groups/public/documents/binario/146674.pdf)

[27] The gross pension replacement rate (median earner) stood at 81.2% in Spain in 2009 whereas the average in OECD countries was 60.6 (OECD, *Pensions at a Glance 2011*: *Retirement-Income Systems in OECD and G20 Countries*, OECD Publishing.

[28] In respect with the gender gap in pensions, see: EUROPEAN COMMISSION – SOCIAL PROTECTION COMMITTEE, *Pension Adequacy in the European Union 2010-2050*, may 2012, pp. 81-86.

gently dealt with later on through political (*Pacto de Toledo*[29]) and social dialogue.

The scene radically changed since the onset of the financial and economic crisis in 2008. As far as the public pension system is concerned, the sharp slowdown of the Spanish economy gave rise to two major threats that became a political priority by 2010 in the context of fiscal consolidation.

The first threat was the rapid deterioration of Social Security's finances. The dramatic employment loss had a direct impact on the financial resources, given the fact that the system's main source of funds is contributions payed by employers and employees[30]. As they direly shrank, the budget surplus of the Social Security decreased rapidly, causing great alarm, and it eventually turned into a budget deficit. That imbalance was pyrrhic in 2011(-0'05% of GDP), but from that moment onwards it gained intensity standing at -1% or over in the following years. That also implied the necessity of financial relief for the Social Security: the Government had to agree to withdrawals from the Reserve Fund[31]. This critical juncture contributed to the widespread idea that the public pension system was not sustainable and that 'structural reforms' (cutbacks) were urgent and unavoidable.

The long-term impact of an ageing population became the second serious threat to pension system sustainability. As we have already mentioned, the age structure of European society will acutely change in the coming decades, Spain

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[29] The 'Toledo Pact' refers to a non-legislative parliamentary committee created in 1995 with the purpose of guaranteeing the future of the Spanish Social Security system. Historically it has played a very relevant role through political support to pension reforms. As we will see, 2013 reform is the exception.

[30] The number of contributors (*afiliados en alta*) went from a highest peak of 19.5 million in July 2007 to a lowest peak of 16.3 in November 2013.

[31] Withdrawals made from the Reserve Fund, being: 7 billion euros in 2012; 11.6 billion in 2013 and 15.3 billion in 2014 (and provisionally 3.7 billion in 2015). The excess income from administration of temporary disability benefit for common contingencies by Social Security Mutuals for Work-related Injury and Occupational Disease Insurance (5.3 billion euros in 2012-2014, plus 2.8 million in 2015) was also withdrawn. See: SECRETARIAT OF STATE FOR SOCIAL SECURITY, *Social Security Reserve Fund. Report to Parliament: Changes* actions in 2014 and status as at 31 December 2014.

being no exception. Quite on the contrary, projections on dependency ratio and life expectancy imply that this demographic phenomenon would affect the Spanish society more intensely[32]. So the attention was drawn to the impact on public finances –pensions, in particular– that the new scenario would bring along. Above all relevant institution (Bank of Spain)[33], think tanks bound to the financial sector[34] and eventually the vast majority of public opinion warned that pension expenditure projection would reach an unsustainability level (17% of GDP) by 2050, so that a profound reform was, here again, urgent and unavoidable.

In conclusion, it appears that the (public) pension's financial difficulties associated with the impact of economic crisis were used to urge the Government –initially socialist– to bring about a pension reform aiming to give response to the ageing challenge. Well thought it reveals a certain confusion regarding the different nature of the two threats analyzed (crisis and ageing). As we have seen, the increasing financial difficulties of Social Security had nothing to do with structural problems of the pension system but instead were caused by the economic recession. That is to say that recovering (part of) the employment loss since the onset of the crisis would have been enough to stabilize Social Security's financial situation.

However, this (recovery of employment loss) was not the case. The priorities associated with an economic policy determined by austerity, and the necessity of reducing public spending favoured that those temporary problems were

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[32] According to the Spanish National Statistic Institute (*Instituto Nacional de Estadística*), a woman aged 65 years in 2064 would live an average of 30.8 years more (27.4 for men), as compared to the current 22.9 survival years (19 for men). And the dependency rate (persons over 64 with respect to persons of working age) would rise from 26.7% in 2013 to 75.7% in 2064, once the group aged 65 and over would account for 38.7% of the total population, instead of the current 18.2% (*Population Projection for Spain, 2014-2064*).

[33] Paradoxically enough given the state of the banking sector, the Governor of the Bank of Spain was one the most active defenders of the necessity of a pension reform as a first one priority (see his speech at the Toledo Pact parliamentary Commission, on the 15th of April 2009, *Diario de Sesiones del Congreso de los Diputados*, n. 256, 2009, p. 2-5).

[34] Among others, see: FEDEA, *Pensiones: hacia un sistema de pensiones sostenible, equitativo y transparente*, octubre 2010 (http://www.fedea.net/propuestas_b/pensiones/pdf/propuesta_pensiones.pdf).

presented as an anticipated warning of the structural difficulties linked to the unstoppable process of ageing. As a result, too many things were taken for granted, especially those related to the spending projections. In a short period of twenty-eight months, two important legal reforms were approved without a real debate on the economic and social consequences that both actions –very different in contents, as we will see– would bring along. Next sections are dedicated to analyze *Act 27/2011, of 1 August, on updating, amending and modernising the Social Security system* and *Act 3/2013 of 23 December on the Sustainability Factor and the Revaluation Index in the Social Security Pensions System*.

C) 2011: A 'TYPICAL' PARAMETRIC REFORM

Rather than a thorough analysis of the long and complex Act 27/2011, my intention deals exclusively with its most relevant characteristics. Three aspects must be examined.

First of all, it is to be noted that 2011 pension reform is based on political and social dialogue. Its content is the outcome – chronologically– of the revised recommendations of the Toledo Pact, agreed by a parliamentary majority on January 25, and the most prominent part of a social agreement reached with the social partners February 2 (*Social and Economic Agreement for Growth, Employment and Pension Guarantees*). The importance of such a wide support not only lies on the additional legitimacy that it gives the (controversial) reform with respect to society; but also on the adverse context in which (pre)negotiations took place: in particular, Zapatero's (socialist) government was subject to a strong pressure towards a pension reform that favoured fiscal sustainability and social dialogue which had repeatedly failed in reforming labour market. In spite of it, the 2011 reform was much more unpopular than the unilateral 2013 one. A paradox occured.

Secondly, regarding the content itself, strongly influenced by the European reform trajectory, the Act 27/2011 strengthens the contributory principle concentrating the legal amendments on the access to retirement pension[35], as an evidence of the goals pursued. Two main provisions must be examined: pensionable age and calculation of contribution period.

Most important legal changes are those regarding pensionable age. Although it is commonly presented as a simple increase of statutory retirement age to 67 years-old[36] (65 up to that moment), the new regulation is much more complex –because of its flexibility– in a two-fold sense.

First, the pensionable age for drawing a full pension comprises the period extending from 65 to 67. That means that retirement (with full pension) is possible when workers have paid contributions for 38.5 years, instead of 37 years as the general rule (35 years according to the former regulation). So it could be stated that the retirement age remains at 65 for workers with 'long' careers –38.5 years is still well under the average in comparative terms[37].

Secondly, the early retirement regulation is also amended to introduce more strict requirements but, at the same time, to widen the opportunities to retire before the normal age with reduced benefits. In substance, it preserves the faculty for early access to pension in crisis situations (essentially, layoffs due to economic conditions) with at least 33 years of contributions and age 63 (61)[38]. What is new is that the law also allows voluntary early retirement beginning at age 65 (63)[39]; in other words, it recognizes a right to early retirement that did not exist before the reform, counterbalancing the revised statutory age.

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[35] See: TORTUERO PLAZA, J.L. *La reforma de la jubilación*, Aranzadi, Pamplona, 2012, p. 81.

[36] See: TEJERINA ALONSO, J.I. *Las últimas reformas en materia de Prestaciones Contributivas del Sistema de la Seguridad Social*, Tirant lo Blanch, Valencia, 2013, p. 27; SÁNCHEZ-URÁN, Y. – GIL PLANA, J. *Pensión de jubilación. Últimas reformas legales*, Civitas-Thomson Reuters, Cizur Menor, 2014, p. 41.

[37] See: OECD, *Pension at a Glance 2013,… op. cit.*

[38] Note that Act 27/2011 provided that it began at age 61, but it was amended upwards (normally 63) before entering into force by the controversial *Royal Decree-Law 5/2013 of 15 March on measures to encourage the continuation of the working life among older employees and active ageing* (see below). A similar amendment suffered the regulation on partially early retirement.

As far as the calculation of contribution period is concerned, the reinforcement of the contributory principle is also evident. Seeking a more accurate proportionality between benefits and previous contributions, the new provision extends the period of reference from 15 to 25 years.

More briefly, the third aspect to be mentioned is that the regulation approved in 2011 did not enter into force immediately. Beginning in 2013 it was foreseen as a gradual implementation until 2027. That was not a minor provision but a factor that contributed to moderate the strictness of the revised requirements, as it offered workers an extra time to examine the pros and cons of the new legal frame so that they could take the most favourable decision[40]. On the other hand, that reform's calendar –given its original support– would recommend prudence when introducing additional measure. That was not the case as the 2013 reform proofs.

Before examining that legislative initiative, it is interesting to make an assessment on the impact of the 2011 reform using the two European-inspired parameters already mentioned. In terms of sustainability, it is arguable that the reform is reasonably positive. In short, the revised (post-reform) public pension expenditure by 2050 showed that it would have increased almost four points standing at 14% of GDP[41]. That was certainly higher than the EU-average spending by 2010 (11,3 and 12,2 in the European Union-27 and the Euro Area, respectively), but it was lower than average expenditure projection in the Euro Area four decades later and, more significantly, lower than the current public pension spending in Member States so relevant as Italy (15,3% of GDP), France (14,6%), Austria (14,1%)[42].

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[39] See former note.

[40] See: SUÁREZ CORUJO, B. *El sistema público…, op. cit.*, pp. 192-197.

[41] All data coming from the *2012 Ageing Report* (p. 332).

[42] The *2015 Ageing report* has revised such expenditure projections upwards, in the case of Italy (14,8%) and France (12,8%), and downwards in the case of Austria (14,6%). It should be noted as well that the same report offers data relative to 2013 pension expenditure: Italy (15,7), France (14,9) and Austria (13,9).

The assessment is different in terms of adequacy. A negative opinion is based on two specific aspects. One is the reduction of replacement rate: the reinforced link between contributions and benefits has an impact on pension's amount especially when previous labor careers were irregular. Given the endemic problem of instability characteristic of the Spanish labour market, and therefore the (relative) difficulty to accumulate long periods of contribution, it is not surprising that the (gross) replacement rate would decline from 80% (pre-reform) to 73,9% (post-reform)[43].

The second critical comment on the adequacy of 2011 reform is that it does not take any serious action to correct one of the structural greatest problems of the Spanish pension system: the gap (40% approximately) in pension provision between women and men[44]. This marked difference determines, among other factors, that older women tend to face higher risk of poverty than men. A (gender) vulnerability that will worsen due to the legal amendments in so far as women work and contribute to Social Security less (in time and in amount) on average[45].

On the whole, the 2011 parametric pension reform aimed to guarantee a public pension system capable of granting more benefits that should be paid a longer time. In return, people would have to work longer to receive a full pension and, if not, would receive a less generous pension. So we could conclude that it achieved a balance between sustainability and (in) adequacy.

D) 2013: A (UNCONSTITUTIONAL?) SYSTEMIC REFORM.

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[43] See: *Spain. Country note: Pensions at a Glance 2011* (*op. cit.*).

[44] See: CONSEJO ECONÓMICO Y SOCIAL, *III Informe sobre la situación de las mujeres en la realidad sociolaboral española*, CES, 2011, Madrid, pp. 202-207.

[45] The average duration of working life in Spain is 37,6 years for men and 30,9 years for woman (EUROPEAN COMMISSION – SOCIAL PROTECTION COMMITTEE, *Pension Adequacy…, op. cit.*, p. 83).

A new policy stage opened in Spain after the elections held in November 2011, whereby the right-wing party (*Partido Popular*, PP) gained an overwhelming majority in Parliament. Initially no action was taken in the pension field, as Rajoy's government concentrated on other 'structural' reforms –noticeably, the labour market–. But things suddenly changed a year later on the occasion of the (then) legally binding adjustment to pension revalorization: the controversial decision to partially freeze public pensions[46] was a signal that announced that further reforms would be implemented. First, it was the *Royal Decree-law 5/2013 of March 5* that provided a more strict regulation on early retirement[47], a keystone of 2011 pensionable age scheme. But, above all, it is *Act 23/2013 of 23 December on the Sustainability Factor and the Revaluation Index in the Social Security Pensions System* that became a legal milestone in the design of the Spanish pension system.

Before briefly analyzing the content of the new regulation[48], some starting problems must be pointed out. The first critical remark lies on the lack of explanation of the grounds that justify a new reform just two years after the previous one. Beyond the broad references to ageing population and economic crisis found in the Preamble to Act 23/2013[49], it comes as a surprise that nothing is said to justify the need of further reforms. In particular, no argument is offered to defend that the estimated outcome of the 2011 reform (pension

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[46] An action of unconstitutionality against *Royal Decree-law 28/2012, of 30 November, on measures to consolidate and guarantee the Social Security system* was brought by the opposition's parliamentary groups lead by Socialist Party (PSOE). Recently the Spanish Constitutional Court dismissed it (Constitutional Court Judgment No. 49/2015 of March 5, see: SUÁREZ CORUJO, B. "The suspension of the pension indexation mechanism and the disappointing Constitutional Court Judgment 49/2015", *Derecho de las Relaciones Laborales*, n. 2, 2015). Almost simultaneously the Italian Constitutional Court held the unconstitutionality of a similar decision on very different grounds (see: SUÁREZ CORUJO, B. "La preservación del derecho a la revalorización de las pensiones en Italia: ¿sonrojo español?", *Derecho de las Relaciones Laborales*, n. 4, 2015).

[47] See: ARAGÓN GÓMEZ, C. – TRILLO GARCÍA, A. "La jubilación anticipada tras el Real Decreto Ley 5/2013", *Revista de Información Laboral*, n. 11, 2014, pp. 57-68.

[48] See a critical analysis In: MONEREO PÉREZ, J.L. *La sostenibilidad de las pensiones públicas*, Tecnos, Madrid, 2014.

[49] Nor could it be found in the report given by the Committee of 'Experts' –mostly linked to the financial sector– appointed by the government in April 2013 with the purpose of studying a future regulation on a new factor of sustainability.

expenditure of 14% GDP in 2050) meant the unsustainability of the Spanish pension system. What that figure revealed is that either extra revenues were generated to finance the projected higher level of spending (3.5-4 percentage points of GDP) or a drastic cutback should be imposed. The government and its parliamentary majority opted for the latter: the critical juncture was used as an implicit justification.

Besides, it should be underlined that, unlike the 2011 reform, Act 23/2013 had neither social nor political support. Rajoy's government was cunning to present the reform under the cover of a 'technical' report. Thanks to it, there was not a firm opposition –not comparable to the one expressed against the labour market reform, for example– and public opinion seemed unaware of the importance of the reform. So the government succeeded in shaping the debate through 'technical' arguments to hide a major political decision.

Closely linked to *Organic Act 2/2012, of April 27, on the budget stability and financial stability*[50], Act 23/2013 regulates two major issues: pension revaluation index and sustainability factor.

Firstly, a new **index for pension revaluation** (*índice de revalorización*) is established based on the expert's proposal. It is important to bare in mind that this is a key element of any pension scheme as benefits are drawn for many years after they are initially calculated and awarded. So changes should always be prudent and clean-cut. In my opinion, that is not the case.

Abandoning the indexation to price inflation, the Law establishes a complex (pension adjustment) formula that takes into account Social Security revenues and expenditures, the number of pensions and the substitution effect[51]; and that

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[50] See Sections 11 and 18.

[51] See Section 48 Royal Legislative-decree 1/1994, which approves the revised text of the Social Security General Law, amended by Section 7 Act 23/2013. The ecuation for this index is: $IR_{t+1} = \bar{g}_{I,t+1} - \bar{g}_{p,t+1} - \bar{g}_{s,t+1} + \alpha \left[\frac{I^*_{t+1} - G^*_{t+1}}{G^*_{t+1}} \right]$, where $g_{I,t+1}$, stands for eleven rolling mean figures, balanced in year *t+1*, of the variation in the Social Security system revenues; $g_{p,t+1}$ (variation in

is subject to a two-fold limit: a minimum revalorization of +0.25% and maximum one equivalent to price index plus 0.5%. The technical analysis of this new formula exceeds the purpose of this paper, but two remarks are to be made before assessing its constitutionality.

First, it is to be noted that this revaluation index is delinked from any standard of living indicator causing uncertainty (potential harm) to current and future pensioners given their vulnerable position[52]. And, second, it reflects a change of nature because the new regulation aims at guaranteeing financial equilibrium as a priority.

Conceptually those features mean that the right to pension adjustment is devalued in so far as revaluation will take place only when the ratio of the social security system's income (contributions) to expenses (benefits) allows it –only an increase of 0.25% is guaranteed–. But in practice it is even worse as it can be estimated that in 2015 pensioners are going to lose purchasing power and that trend will continue in following years[53], first, linked to Social Security's current financial trouble and, later, caused by the intense increase of pensioners. So it is not exaggerated to state that the new formula puts in danger the right to income security in old age itself, increasing the risk of poverty and raising doubts about its constitutionality.

In short, it could be upheld that the new pension revaluation index is unconstitutional on the following three grounds[54]. Firstly, it is arguable that an

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the amount of social security system contributory pensions); $g_{s,t+1}$ (substittution effect, annual variation from year to year of the average pension); whereas I^*_{t+1} and G^*_{t+1} stands for eleven rolling mean figures, balanced in year *t+1*, of the system revenues and expenditures, respectively.

[52] GONZÁLEZ ORTEGA, S. “El nuevo régimen de revalorización de las pensiones”, *Relaciones Laborales*, n. 5, 2014, pp. 153-176.

[53] ILO warns that it will not allow benefit adjustments higher than 0.25% per annum for a certain time (*World Social Protection Report 2014/15. Building economic recovery, inclusive development and social justice*, International Labour Organization, Geneve, 2014, p. 91). In the same vein: INDEPENDENT AUTHORITY FOR FISCAL RESPONSIBILITY, *Opinion on the determination of the 2015 Pension Revaluation Index*, November 2014, p. 9.

[54] More extensively: SUÁREZ CORUJO, B. “Las sombras de la inquietante Ley 23/2013, de 23 de diciembre, reguladora del factor de sostenibilidad y del índice de revalorización del sistema

indexation mechanism that potentially condemns pensioners to lose purchasing power regularly –at least, not exceptionally– does not guarantee income security in old age and, therefore, infringes Section 50 of the Spanish Constitution whereby "(t)he public authorities shall guarantee, through adequate and periodically updated pensions, a sufficient income for citizens in old age".

Secondly, it should be taken into account that pensioners with lower benefits and, thus, at risk of poverty are mostly (approximately two-thirds) women. In that sense, it could be sustained that the new mechanism, albeit formulated in neutral terms, works to the disadvantage of far more women than men. That would involve indirect discrimination against women[55] breaching the prohibition enshrined by Section 14 of the Constitution.

And, thirdly, regarding those who had access to pension before Act 23/2013 entered into force, it could be argued that they had a legitimate expectation not to be at risk of poverty which implies maintaining their purchasing power (otherwise they would have opted to worker longer, for example). Given the fact that the new mechanism is designed seeking financial balance as a priority, there is a potential risk that such legitimate expectations are frustrated. And following the ECJ's doctrine[56], it could be upheld the infringement of the principle that guarantees the certainty that the rule of law shall prevail (Section 9.3 of the Spanish Constitution).

On the other hand, the **sustainability factor** is also regulated by Sections 1-6 Act 23/2013. Beginning in 2019, this new mechanism links the initial amount of retirement pension –it will be applied only once, when the initial pension is

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de Seguridad Social", *Documentación Laboral*, n. 99, 2013, p. 35-56. See also: LÓPEZ GANDÍA, J. "La dimensión constitucional de la reforma de las pensiones", *Relaciones Laborales*, n. 5, 2014, pp. 25-49

[55] See Judgment of the ECJ 20 October 2011 (C-123/10, *Brachner*). See also: (Spanish) Constitutional Court Judgement 240/1999, of 20 de December 1999, 3/2007, of 15 January 2007, and 61/2013, of 14 March 2013.

[56] With regard to the settled case-law on this issue, see Judgment of the ECJ 24 march 2011 (C-369/09, *Polska*) 14 may 2013 (C-545/11, *Agrargenossenschaft Neuzelle*). Specifically on pensions, the European Court of Human Rights (Judgement 17 February 2011) considers that adjustments of pension scheme must be carried out in "a gradual, cautious and measured manner".

determined– to changes in life expectancy by way of introducing a new variable to the formula used to calculate pension amount. Leaving aside technical details[57], the sustainability factor's value will normally be minor to 1 if, as it is projected, life expectancy increases in the long run; so it will represent a 'reduction coefficient'.

The idea behind it –see Preamble to Act 23/2013– is to preserve intergenerational equity guaranteeing the same generosity of the pension system for all retirees, regardless of life expectancy of the cohort to which they belong to. But it actually imposes an automatic reduction cutting the initial pension benefit accordingly to life expectancy. The Committee of experts estimated that the value of initial pensions could be reduced by 6%, on average, every 10 years[58].

In the light of such a weighty reduction, doubts about its constitutionality rise again[59]. In particular, it seems that the impact of the sustainability factor will provoke that in the long run Social Security (pension system as its main benefit) goes into a basic (assistance) pension scheme. That contravenes Spanish constitutional doctrine on the public pension system that considers that its goal is not just the reduction of poverty ("… a sufficient income for citizens in old age"), but also to guarantee "adequate pensions" which implies certain relation between contributions and benefits[60]. The sustainability factor puts in danger the aimed adequacy by way of generating 'shrinking' pensions. Therefore it could be breaching Section 50 of the Spanish Constitution.

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[57] The formula is the following (Section 4 Act 23/2013): $FS_t = FS_{t-1} * e^*_{67}$. Where e^*_{67} represents the variation of life expectancy at 67 (according to Social Security's population mortality tables) within a five year period, using as a numerator and denominator the life expectancy in first and last years of that period, respectively.

[58] See: *Informe del Comité de Expertos sobre el factor de sostenibilidad del sistema público de pensiones*, 7 June 2013 (http://www1.seg-social.es/ActivaInternet/groups/public/documents/rev_anexo/rev_032187.pdf).

[59] See: SUÁREZ CORUJO, B. "Las increíbles pensiones menguantes: la metamorfosis del sistema público de pensiones a través del factor de sostenibilidad", *Relaciones Laborales*, n. 5, 2014, pp. 145-151.

[60] See: ARAGÓN GÓMEZ, C. *La prestación contributiva de Seguridad Social*, Thomson Reuters-Lex Nova, Valladolid, 2014, pp. 63-70.

Not surprisingly, the impact of the 2013 reform is remarkable. As reported by the Spanish government[61], both measures result in an expenditure moderation of 3.4 percentage points of GDP in 2050 compared to the projections without reform. That means that there will be no threat to sustainability of pension spending by that year; as a matter of fact, just a slight increase in foreseen. Nevertheless attention should be drawn to two specific issues.

Firstly, pension expenditure presents a sharp drop between 2050 and 2060, as it will stand at 11% of GDP then, almost a percent point less than today. It shows that the ageing challenge has a deadline, a circumstance to be assessed before implementing (too aggressive) reforms. And, secondly, those figures tell us that in thirty-five years time (public) pension spending will amount the same –approximately – as today, but with a very important difference that we should not overlook: by that time old-age population will have almost doubled.

Obviously, that means that due to the 2013 reform we will see a huge sacrifice of (public) pensions in terms of adequacy in coming years. Coming back to the most interesting *2015 Ageing Report*, a very substantial decline is projected for public pensions in Spain with respect to the two indicators previously mentioned: benefit ratio (-25.3 percentage points, the second largest decrease) and gross average replacement rate (-32.2, the highest drop).

In view of the magnitude of these legal changes, we could conclude that the 2013 public pension reform entails a model's switch ('disruption'). So that the new pension scheme drives the public scope to shrinking and devaluing pensions while it opens –in a certain way, guaranteeing– a space for private pension development. Beyond the constitutional objections, that is a legitimate policy option. But citizens should be warned of two potential risks associated to those two features: the (re)emergence of poverty in old age and inequality.

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[61] See: *Stability Programme Update 2015-2018*, p. 70 (http://ec.europa.eu/europe2020/pdf/csr2015/sp2015_spain_en.pdf)