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## ***THE PENSION SYSTEM IN SPAIN***

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### ***FORUM***

***Social Security Reform and Pensions in the  
United States: Lessons from Europe***

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## I. GENERAL FRAMEWORK OF THE SPANISH SOCIAL SECURITY SYSTEM

### The Social Security model in Spain

The principal legislation which encompasses the regulations governing the pension system in Spain is the Adapted Text of the **General Law of Social Security**. This legislation covers the enactment of all norms since 1967 ( when Spain's current model of Social Security came into effect) together with their development, modification, and updating of the legal framework of benefits and the economic scheme of the System

The most recent update of this legislation was provided by **Act 24/1997, consolidating and streamlining the Social Security System** which entails the expression of the principles of solidarity between generations as well as the need for the existence and viability of a public Social Security System of a contributory nature within the goals of financial and budgeting balance, in the framework of social dialogue.

The Social Security legislation forms a part of the public social protection established in Spain, and is independent from other specific laws such as those involving protection of civil servants, and military personnel, which however, together with unemployment benefits, are not dealt with in this paper

Application of the foregoing principles have determined the current model of the Spanish Social Security, which has the following characteristics:

- a) **Field of application**, defined as the sum of the active or passive population covered by Social Security, encompassing the entitled, and where applicable, their beneficiaries. This protection is differentiated according to what corresponds to the **contributory level** in which the right to social benefits is generated according to the activity engaged in, and the amount of benefits is related to salaries, or the **non-contributory level** in which right to benefits is a set amount, and of a universal nature for those of whom, because of lack of sufficient resources, have not been able to access the right to contributory economic benefits. Also included here are universal health care and social services.



- b) **Structure of the system**, divided into several schemes at the contributory level according to the activity carried out. A General scheme of workers and various special schemes also exist which incorporate collective workers with particular conditions such as being self-employed or an agricultural, coal mining, maritime, or domestic help worker.

At the non-contributory level, previous contribution is not required to receive economic benefits. The essential requirements for receiving a pension are legal residence in Spain, and lack of sufficient income.

- c) **Protective action**, defined as the sum of benefits offered by the system, and are of an economic character or in kind.

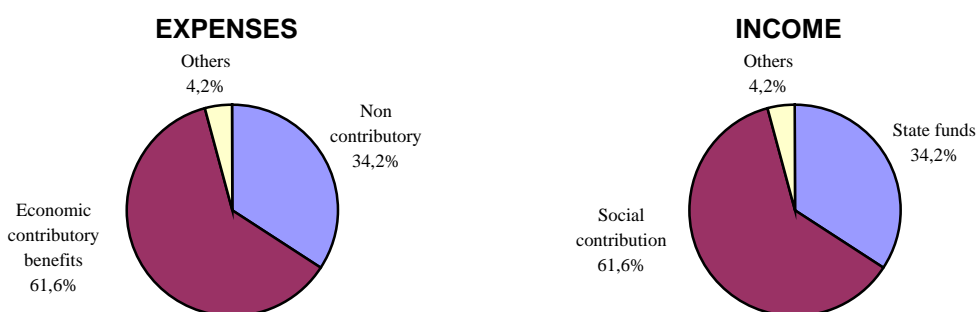
**The benefits which are included in the contributory area are pensions** (retirement, permanent disability and survivor) generally of a **life-time** nature, **and other economic benefits** among which the most important are temporary disability, maternity leave and high-risk pregnancy leave.

**Included in the non-contributory area are retirement benefits, permanent disability, and family allowances** (with previous proof of lack of financial resources), **the complements for minimum pensions, health care and social services**, with the latter two considered as benefits in kind.

- d) **The economic financing system** which is characterized by the application of a financial system of pay-as-you-go necessary for financing all of the benefit payments, excluding those derived from occupational injury/illness for which a funded system of coverage is applied. The types of contributions are not uniform for all of the schemes, and the balance of the system in the establishment of the budget as well as its liquidation is done at the global level, which also introduces an element of solidarity because of the redistribution of outcome among schemes.

There are three **financing sources**: **social contributions** proceeding from companies and their employees, **State funds**, and **other income** which is of a residual nature and serves also to finance the system. As already pointed out, the

**social contributions basically finance the contributory benefits and the State funds (proceeding from tax revenue) the non- contributory benefits.**



### **Recent processes of reform**

The latest reforms carried out in the system with the aim of perfecting it and maintaining its future viability, and taking into account the most recent and most representative in order of importance, are the following:

- a) **Act 26/1990 which establishes the system of non-contributory Social Security benefits.** This law allows for the amplification of the protecting action of the system and thanks to the financial reform, the greatest expense accrued does not have negative repercussions in the contributory area as it is financed by State funds derived from tax revenue.
- b) **Act 24/ 1997** consolidating and streamlining the Social Security System including the following measures:
  - **Separation of financing sources** of expenses according to kind, consolidating the principle of the financing of the non-contributory benefits by State funds.
  - **The constitution of a Reserve Fund** with the surplus of contributions to mitigate the effects of economic cycles.
  - **The establishment of a single limit** for contributions for all of the different professional categories with maximum observance of the effect that this measure could have in competitiveness and employment.



- . **The introduction of a greater number of factors of contribution and proportionality** in accessing and determining retirement pensions with the aim of reflecting the total amount of contribution toward economic benefits.
- . **The application of the equity principle** via the modification of pensions for a surviving spouse and for orphans.
- . **The determination of automatic revaluation of pensions** in accordance with the evolution predicted by the Consumer Price Index.
- . **The establishment of incentives** for workers older than 65 to remain in the work force.

This law of consolidation was the result of approval in 1995 in a Congress plenary session of the text publicly known as the “**Toledo Pact**”. The agreement supposed a wide consensus on the development of article 41 of the Constitution with respect to the vested commitments and principles of solidarity between generations to guarantee the survival and viability of a public Social Security of a contributory nature. **It likewise was fruit of a commitment by all parliamentary powers to make the current Social Security model financially viable**, with a view to needs of growing magnitude in the coming decades. **Thus the principle materialized that political agreements regarding Social Security matters could count on maximum social support.**

Likewise fruit of the social dialogue thus established, was the Agreement on Consolidation and Streamlining of the Social Security System, which, signed by the Government and Union organizations, leading to the law contained in Act 24/1997, and also the Agreement for improvement and development of the system of social protection, reached in April 2001 by the Government and its social partners, deepening the referred to political commitments and demonstrating the **unequivocal will of all parties in favor of social dialogue.**

The Toledo Pact, has a clear intent of permanency. In this sense, it should be pointed out that its framework for development provides for the creation of a Congressional Committee which studies the present and future of Social Security every five years, so



that at any given time, appropriate measures can be adopted to guarantee the continuity of the system.

### **Pensions.**

The reposition rates which encompass the relation between the gross pension generated and the last gross salary received, offer a range of results which depend on three basic elements affecting the amount of the pension: the salary level in the period considered to determine the regulated base of the pension, the total number of years of contribution, and the age of retirement.

**The reposition rates for retirement at age 65 oscillate between 95.1% for 35 years of contribution** and 47.6% for 15 years of contribution, both cases being calculated on average contribution base. In order to obtain a pension equivalent to 100 percent of the regulated base, 35 years of contribution are required; shorter periods yield different reposition rates. Of the total number of retirement pensions, 25 percent have to be complemented to reach the legal established minimum.

**The general revaluation is made by using as a reference the annual change in the Consumer Price Index (CPI).** The Law provides for a guarantee of the maintenance of buying power of the pensions so that if there is a discrepancy between the predicted CPI and the present one, pensioners are guaranteed the receipt of the corresponding difference. The current legislation likewise allows for gradual retirement for workers who are 62 or older, who can complement their partial retirement with a part-time job until reaching the age of 65.

The legislation does not differentiate with regards to the formula for calculation of retirement pensions for men and women. The pensions have the same formula in relation to working life, by which a goal of equality is totally incorporated into the system.



## Contributions

**Financing pensions is carried out at the contributory level by the social contributions of companies and workers.** The level of these contributions is linked to the contribution rate, the contribution base and the total number of persons registered in the system.

The **contribution** rate for the General Scheme is 28.3 percent, of which 23.6 percent is paid by the company and 4.7 percent by the worker. This type is the same for special schemes for maritime and coal mining workers and for the special scheme of self-employed workers, although in the latter, contribution is made solely by the self-employed worker. The agricultural workers and domestic workers have different rates and distributions, and in any case, are lower. There is also a specific contribution to finance unemployment benefits and those arising from work-related accidents.

The second element determining the **level of income** in the system is the contribution base, which is established with the gross salary received, providing that it is situated within minimum and maximum limits that are established annually for each category in the Law of State General Budgeting.

The third element is the **number of persons registered in the Social Security**, whose increase in the last years has permitted at the present stage of economic growth, levels of income reaching a budget surplus in the Social Security System. This situation will be attempted to be maintained in the future, through, among other things, measures to foment employment policy and which have allowed for the creation of a Reserve Fund.

The favorable evolution in employment has made it possible to achieve a total growth of 3.4 million registered in the period 1996-2001, which is an increase of 27.5%. Logically this situation has improved the active-passive relation (system dependency ratio) currently situated at 2.30, as opposed to the 2.06 in 1996.

## The complementary system

Article 41 of the Constitution provides for the existence of a free complementary system. The implementation of this system is carried out through the Law of Pension Plans and Funds of 1987, whose basic characteristics are the following:



- Free and of a voluntary nature
- Financed through Funds

Divided into 3 categories

- Individual system
- Associated system
- Employment system

The main use of these pensions plans outside the Social Security System have been concentrated in the individual system, while in the other two, repercussions have been scant, leading the Ministry of Economy to evaluate the need to stimulate employment programs in order to create a more attractive new framework together with incentives that would foment growth in this area.

## II. THE FUTURE CHALLENGE

### The current situation of the Social Security

In the area of the already detailed systems of pensions, and relating to the current debate within the framework of social dialogue and the Toledo Pact, it is considered of essence **to continue with the policy for improving certain pensions, particularly those of, surviving spouses, as well as reinforcing the principles of equity and introducing a greater number of factors of contribution and proportionality** which must reflect in the amount of the pensions a stricter relation with the contributions carried out in the period of work activity.

Likewise, the procedures for **pre-retirement** are currently in debate, which in the case of a mass company layoff can be described as a situation of a worker leaving the work force at an older age but before retirement, without the right to a retirement pension until he/she reaches legal retirement age. In this situation, the cost that these procedures entail for companies are partially financed by social protection systems, through unemployment benefits, as a guarantee exists for workers to continue receiving payments from their companies until the age of retirement. This situation influences the level of the pension as the contributions made during these procedures correspond to the minimum base.



A different case would involve that of **early retirement** which permits certain types of workers to retire between 60 and 64 years of age ( the legal age of retirement is 65 at present) with the application of a reduction rate derived from said application. The only workers who may retire under these conditions are those who have accredited contributions to the system before January 1, 1967, after which date the age of retirement was established at 65. This case of early retirement thus is a limited situation.

However, an agreement has been reached to create a new practice which permits workers registered before January 1, 1967 to retire at 61, provided they meet the necessary requirements, especially those related to unemployment.

### **The aging of the population**

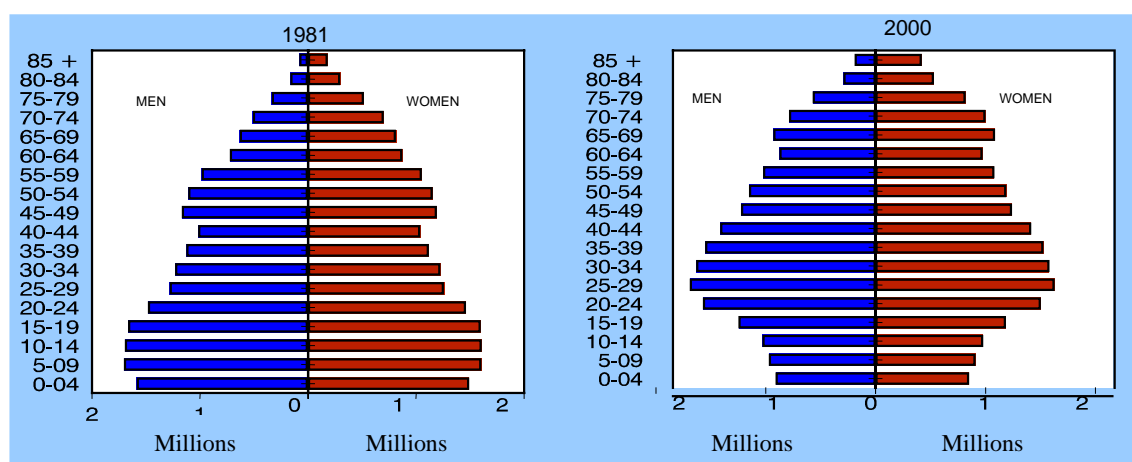
In Spain, as in the other countries of western Europe, the principal challenge facing pension systems is the aging of the population, fundamentally manifested in an increase in life expectancy and a decrease in the birth rate which result in making generational recuperation difficult. Nevertheless, the compensatory effect that immigration can have in this process must also be considered.

According to data from the Central Statistical Office, the evolution of the composition of the population by large age groups in the period from 1960 to 2000 and the future projection for 2020 reflect a decrease in the population in the age group of 0-19, and an increase in the 65 or older group.

#### **Age groups**

<b>Years</b>	<b>0-19</b>	<b>20-64</b>	<b>&gt;=65</b>	<b>%Total</b>
1960	35.4	56.4	8.2	100.0
1970	35.7	54.5	9.8	100.0
1981	34.4	54.4	11.2	100.0
1991	28.0	58.2	13.8	100.0
2000	20.9	62.0	17.1	100.0
2005	19.4	62.8	17.8	100.0
2010	19.1	62.2	18.7	100.0
2020	18.9	60.1	21.1	100.0

In the graph, it is important to point out the figures indicating that less numerous generations born during the civil war now reaching 65 years of age permit the availability of a margin for maneuver as of 2000, a factor which facilitates the adoption of measures to compensate for, as of 2020, the effects on the social protection of the increase in the population, fundamentally derived for the baby-boom era, associated with a greater life expectancy.



### The evolution of the active population

The amount of the population at working age is the principal determinant of the active population. The legal age for working in Spain is 16, although, in practice that age is being prolonged because of the educational system, resulting in the present rate of activity between 16 and 19 of 28.1 percent, as opposed to the 32.3 percent in 1990. A characteristic to point out is that the aging process will effect this age group so that in the future there will be a greater concentration in the work force of the 55-65 age group, demonstrating the need and opportunity for increasing employment in the 16 - 19 age group.

According to data from the Survey of the Active Population, the activity rate for men calculated in relation to the population between 16 and 64 years old increased from 74.1 percent in 1994 to 76.5 at present, and the rate for the same period for women grew from 44.6 percent to the 51.5 percent current rate.



The occupation rate also calculated based on the population between 16 and 64, shows that of men growing from 59.4 percent in 1994 to 69.4 percent in 2000, while for women the rate grew from 30.6 percent to 41.0 percent. This situation demonstrates a strengthening in the labor market during this period, although given the difference that exists between the two collectives, it is necessary to foment measures stimulating the incorporation of women into the labor force and that reduce the differences between the two groups. The joint occupation rate went from 45.0 percent to 55.2 percent in the period 1994-2000.

In the short term the predicted evolution of employment in the Program for Stability, for the period 200-2004, will be at a occupation rate of 60.3 percent in 2004, near to reaching the average level of occupation for the E.U.

This employment situation will have positive repercussions in those registered in the Social Security System who finance the system through social contributions. In this area the measures of stimulating the labor market to obtain adequate levels of occupation will allow the system of pensions to be maintained.

### **III. MEETING THE CHALLENGE**

In the ambit of debate and discussion that is carried out as a necessity of reflection and decision-making in the framework of social dialogue, it is seen as essential that reform efforts be concentrated in the following actions relating to the pension system:

**Promoting workers' permanence in the work force**, via measures that foment the prolongation of working life beyond 65, having the two-fold financial effect of a longer period of contribution, and a shorter period of pension payment.

Establishing criteria which allows for improvement of already existing measures in Spain to **foment partial retirement**, permitting gradual and flexible worker retirement, so that a greater compatibility exists between work and receiving a pension, facilitating the gradual transition from an active situation to a passive one.

**Curbing the proliferation of early retirement situations**, defined as the premature end of working life of older worker who have not reached the legal age of retirement.



**Facilitating a greater integration of women into the labor market**, based on measures which favor balancing working life and family life.

Introducing into the system for calculating retirement pensions **stricter criteria for equity and a greater number of factors of contribution and proportionally** permitting the amplification of the time period considered in establishing the calculating base of the pension, which currently is 15 years.

Continuing a **policy of greater increases in smaller pensions**, with priority in those that present a greater need for increase due to being at a minimum level, particularly for surviving spouses.

**Progressing in the separation of financing sources** so that the amount of the complements for minimum pensions have greater financing through the State General Budgeting, which will allow improvement of outcomes at the contributory level and aid in the maintenance in the coming years of the Social Security System surplus.

**Continuing in the accumulation of the amount of the Reserve Fund**, which began in 2000, thereby providing for the guarantee of the balance of the system that compensates for future negative cyclical effects. In the Program for Stability for the year 2004 a goal has been established to reach 1 percent of the GDP in said fund.

In the framework of the **complementary schemes**, which guarantee an additional pension in the ambit of the Pensions Funds, constituted in the private sphere as voluntary protection and based on a financial funded system, **incentives will be fomented by the Government** for these employment systems that, for companies which have voluntarily established them within their negotiation processes with social partners, have, at the present, little popularity.