Higher relative income of the 65+ than in most countries

The pandemic has taken a heavy toll all over the world, and excess mortality reduced life expectancy at birth by 1.5 years in Spain in 2020. Despite the COVID-19 crisis, old-age income and pension entitlements have been well protected in most OECD countries including Spain.

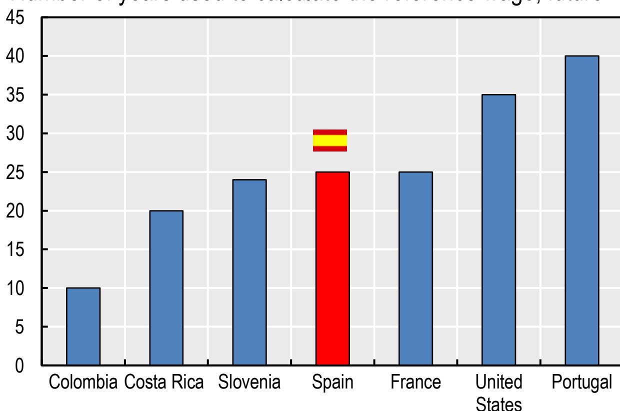
In 2021, Spain increased family-related pension benefits by introducing a supplement for pensioners who have had children, at EUR 378 per year (1.5% of average wage) and per child. Before the COVID-19 crisis, people older than 65 had an average income equal to 96% of that of the total population, higher than the OECD average of 88%. Average relative incomes grew substantially faster for older people in Spain as this ratio was around 85% in 2000. This is consistent with the increase in pension spending, by about 3% of GDP since 2000 (and before COVID-19), which is one of the highest in the OECD. Demographics explain only half of this and, as in Finland, Greece, Portugal and a few other countries, pension spending per retiree grew much faster than the average wage. In Spain, demographic shifts were delayed relative to other OECD countries, but ageing will now accelerate at a very fast pace, putting strong pressure on financial sustainability.

Conditions for full pensions are loose

In Spain people who have contributed for at least 37.25 years (rising to 38.5 years from 2027) can retire at age 65 with a full pension. This contribution-period condition is loose in international comparison, except for Italy that temporarily has 38 years for Quota-100. Greece and Slovenia will also continue to have a relatively short period of 40 years, while France will have 43 and Germany 45 years. Moreover, the large majority of OECD countries take into account wages throughout the whole career for calculating pension benefit. Within the EU, only France, Slovenia and Spain use 25 years or less.

Few countries use only part of the career for pensions

Number of years used to calculate the reference wage, future



Source: Pensions at a Glance country profiles

Replacement rates are high for dependent workers

The pension system will continue to deliver high replacement rates even with short careers. For full-career average-wage workers the future net replacement rate would have been 80% at the average wage based on the sustainability factor. Now that it has just been eliminated, it is equal to 89% compared with 62% in the OECD on average. This high replacement rate will be eligible at 65 years, while the same level will require working until 69 years in the Netherlands, Italy will have 82% at age 71 and Denmark 84% at age 74.

In Spain, self-employed workers pay substantially lower mandatory pension contributions – only flat-rate as in Poland and Turkey – than employees. The future pension of the self-employed with full careers is 43% of that of employees when both have the same taxable income equal to the average wage, which is among the lowest in the OECD.

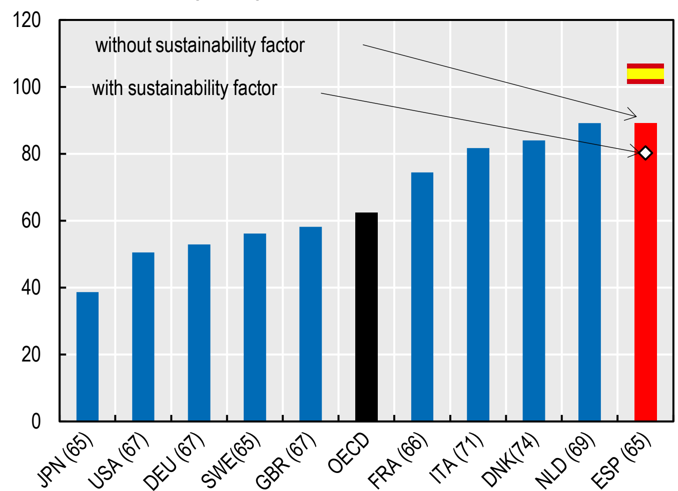
Automatic adjustment mechanisms have been eliminated, and replaced by the "Intergenerational Equity Mechanism"

Compared to alternative discretionary changes, automatic adjustment mechanism (AAMs) can be designed to generate changes that are less erratic, more transparent and more equitable across generations. Spain is among the third of OECD countries with no AAM beyond pension indexation to prices or wages. Under increasing pressure, the Revalorisation Pensions Index (IRP) was replaced by price indexation in 2019 while the sustainability factor has been eliminated, and replaced by a new instrument called Intergenerational Equity Mechanism (IEM).

AAMs adjusting pension indexation based on demographics are powerful tools to provide financial resources to improve sustainability and can share the burden between workers and pensioners. However, the IRP led to pensions in payment growing less than prices, and projections indicated that this would have continued. AAMs leading to pensions steadily declining in real terms are questionable as retirees have little possibility to adjust their income.

Future net pension replacement rates

Full-career average-wage workers in the private sector, %



Source: Table 4.4

The sustainability factor would have automatically adjusted benefits to longevity, similar to what NDC (notional defined contribution) pensions do in six OECD countries as well as in Finland for its defined benefit system, while annuity levels in funded DC schemes are automatically adjusted to life-expectancy projections. Such an instrument highlights that current contributions cannot finance the same pensions over a longer retirement period driven by longevity gains.

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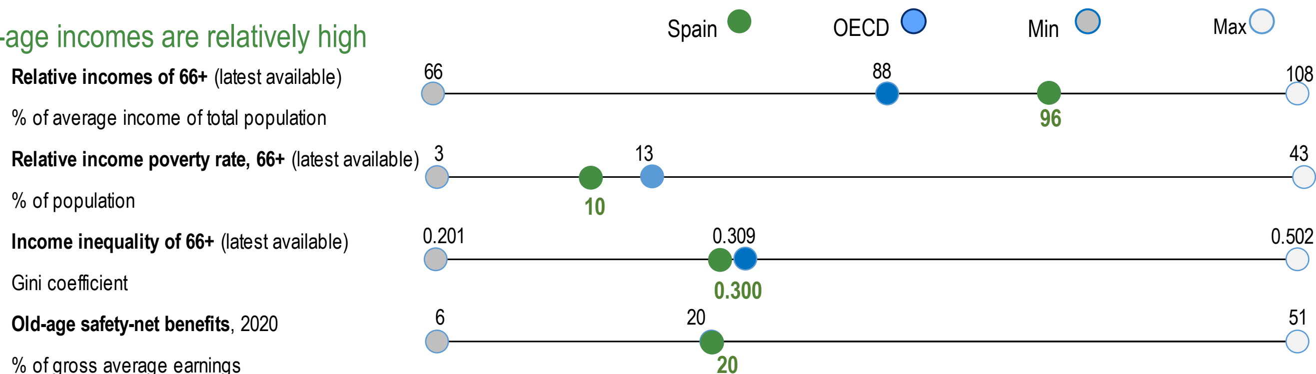
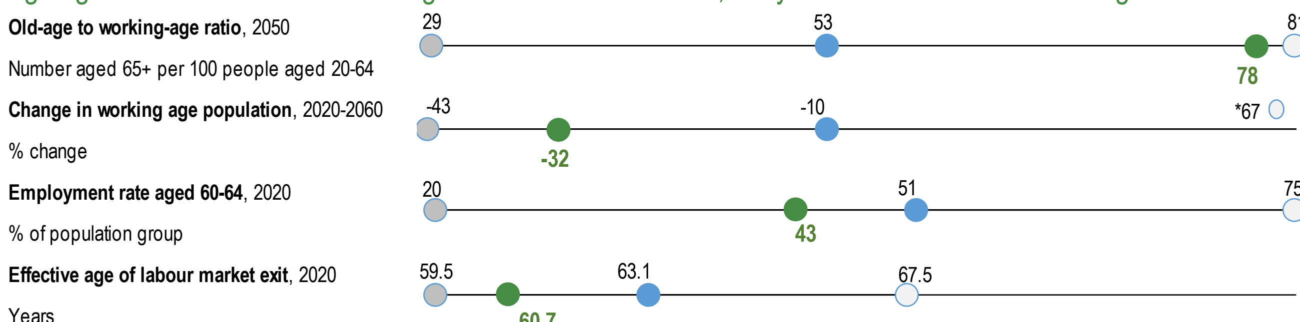
The Spanish case illustrates that a consistent policy over time requires a wide political consensus before implementation. Otherwise, measures risk being politically unsustainable, leading to reversals and weakening confidence. The fate of the IRP also shows that corrective measures need to be implemented soon enough. When financial sustainability has to be restored, measures must be taken irrespective of how some indicators will develop: AAMs are no substitute for a bold discretionary measures in a financially unbalanced pension scheme.

As part of the Resilience and Recovery plan, the European Commission requested that a pension reform proposal be presented in 2021. The government and social partners reached a preliminary agreement in July 2021 according to which pensions will be indexed to prices and bonuses and penalties modified to encourage working longer. Moreover, he sustainability factor will be replaced by the IEM. Backed by a majority in Parliament on 2 December 2021, the IEM consists of an increase in the contribution rate of 0.6 p.p. (0.5 p.p. for employers and 0.1 p.p. for employees) up to 2032, with additional contributions being accumulated in the public pension reserve fund. This will help mitigate the financial impact of the baby-boom generation reaching retirement. The accumulated funds would amount to a stock of 2.3% of GDP in 2032. The EC Ageing Report estimates that the replacement of the IRP by CPI indexation alone will increase annual pension spending by 1.4% of GDP in 2030 and by 2.6% of GDP annually from 2050.

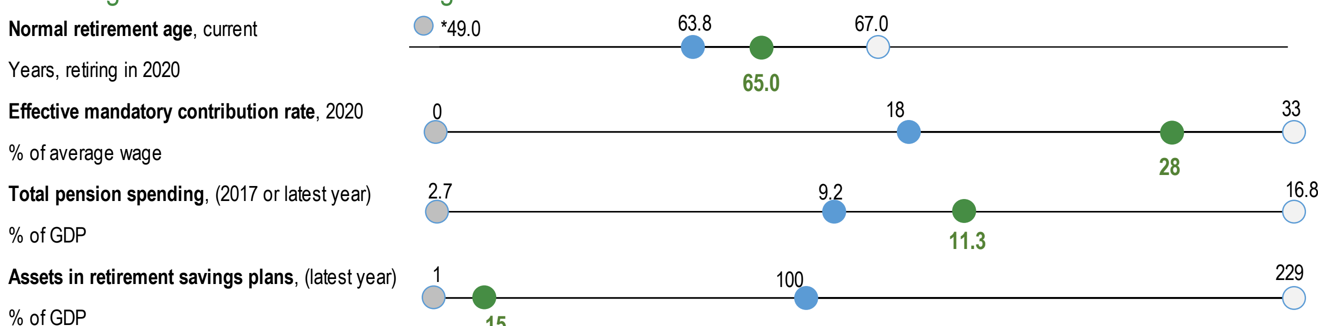
Old-age incomes are relatively high



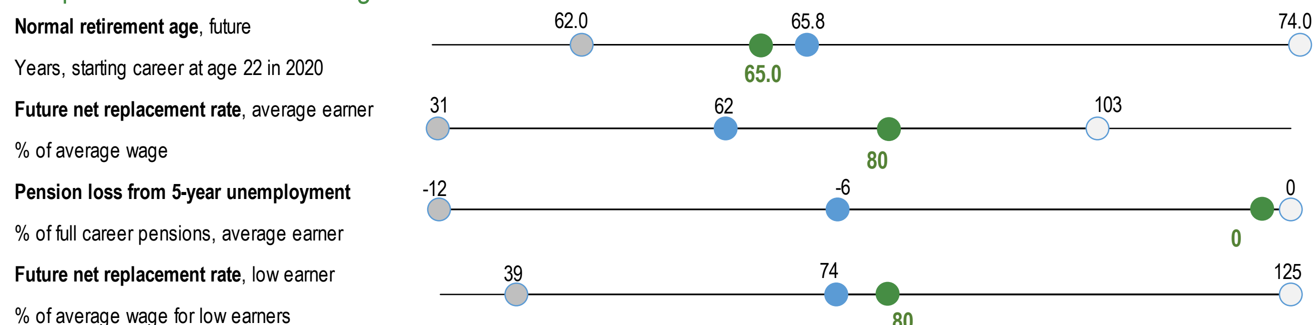
Average age of labour market exit among the lowest in the OECD, 2.4 years below the OECD average



Retirement age is above the OECD average and will remain constant



Future replacement rates will be high



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