Spain’s Pension Outlook: Sunny with a Chance of Austerity

By Kerry Pechter *Thu, Jan 18, 2018*

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The historic center of Seville, Spain, is a labyrinth of shaded alleys and sunlit plazas. On a mild afternoon this week, clusters of silver-haired men and women began to congregate informally at some of the countless tapas bars and sidewalk cafes that you’ll find here.

Dressed too plainly to be tourists but too well to be unemployed, they could only be representatives of Spain’s 5.9 million pensioners. “Jubilacion” is the Spanish word for retirement and, indeed, they seemed to be enjoying what looked like a daily ritual.

As well they can. Spain has traditionally offered Europe’s second most generous state pension (after Greece). Averaging €12,000 ($13,200) per year (with a cap of around €36,000 ($43,200) per year, it replaces about 80% of final salary, on average. Retirees get 14 “monthly” checks per year.

But these are confusing times for Spanish retirees and near-retirees. The pension is changing. The government has been periodically tweaking the formulas that determine the pension payouts. With all the changes—some of which are being debated in Spain’s legislature right now—it’s hard for most people to tell if they’ll be net winners or losers.

“For most citizens facing the calculation of the pension is a real puzzle, a cumbersome issue that has been further complicated by the successive reforms of the system,” said a front-page article this week in *El Pais*, Spain’s biggest newspaper.

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No option to devalue

While the U.S. keeps kicking its Social Security problems down the road—to the point where our Millennials don’t expect it to “be there” for them, where the “trust fund” or reserves is about to hit empty and where payouts will drop by about 25%s in 2034 if no reforms occur—several factors have forced the Spanish to deal with theirs.

Those factors include the crash in payroll tax revenues after the 2008-2009 financial crisis, an aging population with a low fertility rate (the median age is expected to reach 55 by 2050) and pressure from the

European Union to put its fiscal house in order.

As you may remember, Spain was one of the four Mediterranean countries (with Greece, Italy, and Portugal) hurt most (and criticized most) in the European financial crisis and real estate bust. In depressions past, these countries might have devalued their currencies, but membership in the eurozone eliminates that option.

In 2012, the Spanish government began using its Social Security Reserve Fund for current spending and debt payments, according to press reports. The reserve dropped to €15 billion in 2016 from over €66 billion in 2011. The government recently loaned €10.1 billion interest-free to Spain’s social security system, which it used to pay out the two extra pension payments due in June and December. In 2016, the system registered its biggest deficit in its history (€18.1 billion), which was covered by the reserve.

Here are some essential facts about Spain’s public sector pension:

¶ Spaniards will contribute longer to their pensions and take their pensions later. From 2013 to 2027, the official retirement age will rise to age 67 from age 65. The number of contribution years required for the minimum pension remains at 15, but the requirement for the maximum pension has risen to 38.5 from 35 and the payout will be based on salaries in 25 of those years instead of the traditional 15. The legal age for early retirement will rise to 63 from 61.

¶ Spanish workers and their employers pay a lot in taxes for their pension and healthcare benefits, which are both covered by “social security” taxes. In 2017, according to Pricewaterhouse Coopers, “The general contribution rates as from January 2017 are 6.35% for employees… and 29.90% for employers, plus a variable rate for occupational accidents (e.g., 1% for office work).” The minimum monthly base was €825.60 ($1,006) and the maximum is €3,751.20 ($4,576) in 2017.

¶ About 5.9 million people (of a population of about 46.5 million) receive a retirement pension in Spain, which is called the *Pension por Jubilacion Ordinaria*. In 2016 the average state pension was €1,071 or about $1,250 per month (compared with $1,369 in the U.S.) Contributory retirement pensions in Spain are Europe’s second highest (after Greece) and equal about 81% of final salary levels.

¶ The maximum pension is currently €2,573.70 ($3,140) per month, but some recipients qualify for two extra payments per year so that the annual maximum is €36,031.80 ($43,960).

¶ Spaniards can retire early as age 60 if they started working before January 1, 1967 and have they’ve contributed to the system for at least 30 years of contributions. But the pension benefit is reduced by 8% for every year of retirement before the age of 65, so the pension at 60 is 40% less than the full pension.

¶ Delayed retirement has benefits here, as in the U.S. If someone reaches age 65 with 35 contribution years, two percentage points are added to the multiplier for every added year in employment. Those with 40 contribution years see an increase of four percentage points.

¶ Like several other European countries, Spain is adding a “sustainability factor” that will make sure that pensions don’t grow faster than resources. Starting in 2019, instead of indexing pension payouts to inflation, increases will be based on changes in life expectancy, the number of pensioners, “the level of pension payments over a duration of time, and the financial situation of the social security system,” according to **pensionfundsonline**. Since January 1, 2014, pensions have increased only if the system is in surplus.