The financial crisis of the public pension system in Spain[1]

La crisis financiera del sistema público de pensiones en España

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Abstract:
Both Colombia and Spain are states that face overcrowding of the elderly in their pension system, according to the figures presented at the II World Assembly on Aging in Madrid (UN, 2002), which discussed issues of a considerable increase in the population of older adults, not only in Developed countries, but in all countries of the world. This increase in the elderly population has caused financial problems to the different pension systems in the world with respect to sustainability and the funds available to guarantee the right to a pension for older persons of retirement age. In Spain, especially, it is said that there is an imminent crisis in the Public Pension System. With the following article, it is aim to analyze the Spanish public pension system, describing its components and the incidence of its changes since the 1978 constitution.

Keywords: Pension system, sustainability, crisis, pension, and elderly.

Resumen
Tanto Colombia como España son Estados que afrontan sobrepoblación de adultos mayores según las cifras expuestas en la II Asamblea Mundial sobre Envejecimiento de Madrid (ONU, 2002), donde se discutieron temas sobre el aumento considerable de la población de los adultos mayores, no sólo en los países desarrollados sino en todos los países del mundo. Este aumento en la población de adultos mayores ha ocasionado problemas financieros a los diferentes sistemas pensionales del mundo con respecto a la sostenibilidad y a los fondos con los que se cuenta para garantizar el derecho a una pensión a los adultos mayores en edad de jubilación, especialmente en España, donde se habla de una crisis en el Sistema Público de Pensiones. Con el siguiente artículo, se analiza el sistema público de pensiones español, haciendo una descripción de sus componentes y la incidencia de sus cambios desde la Constitución de 1978.

Palabras clave: Sistema pensional, sostenibilidad, crisis, pensión y adulto mayor.

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THE FINANCIAL CRISIS OF THE PUBLIC PENSION SYSTEM IN SPAIN

According to the most recent statistics, the number of adults over 60 has increased by 560 million more between the 1950s and the year 2012, with an estimated increase of nearly 2 billion by the year 2050[2]. That is, the demographic increase of this population of older adults has a constant and accelerated growth of 9.3 million per year approximately, which would mean that by 2050 about 2 billion people over 60 years would be unemployed waiting for an old-age pension, at least to continue with an acceptable quality of life or access a dignified old age.

However, prior to the Spanish Constitution of 1978, the legislation on Social Security of that country already defined a fundamental change is experienced in the structure and in the way Social Security is understood, which implied constitutionalizing Social Security and every component of the system, since the text of the supreme norm proposed some rather specific responsibilities at the head of the Spanish State, in favor of improvement of the quality of life of Spaniards, specially to those most vulnerable (Dueñas, Riaño, Palacios, & Sierra, 2011, p.361).

Once the Social Security is constitutionalized, the Spanish State has the obligation to guarantee a vital minimum not only in health, but in all the components of Social Security addressed to the elderly, including the old-age pension. This modification brings with it an additional burden for the public budget and a need for economic resources for its support. Moreover, the Public Pension system reports a deficit while there aren't enough funds to divide among the elderly because of the increasing number of people getting that age.

Therefore, it can be affirmed that the public pension system in Spain is also based on the same constitutional foundations of the Pension system in Colombia, sharing the same problems of economic sustainability, the same resource needs, and the same coverage limitations of this fundamental right that older adults have at retirement age. In Colombia, in the other hand, pensions are financed with the contributions of employers and workers, the resources of the general system of participations, the Solidarity and Guarantee Fund (hereinafter, "Fosyga").

In Spain, pensions are financed through of taxes as well, but pensions are a right to every elderly whether he or she had or had not work. Indeed, it can be summarized that the system is unfortunate, since there are no other sources of public revenue to solve future problems of financial sustainability. According to Dueñas et al (2011) the essence of the pension system in Spain, is that of being public pensions, where the State sets requirements, contributions, the amount, there is a treasury, it collaborates economically and, therefore, it is not an individual savings regime (p.374).

2 Ageing in the Twenty-First Century. A celebration and a challenge, 2012, p.190.

A. Structure of the Spanish Public Pension System

The pension systems of different countries of the world have different ways of structuring themselves, according to their public policies or their legal guidelines. In Spain, there are three regimes or methods of distribution: method of distribution of hedge capital, method of capitalization and a mixed method of capital distribution and capitalization. In the method of distribution of hedge funds, the elderly person of retirement age does not have a right to a pension properly, since his enjoyment will depend on funds available.

For instance, the funds available are those collected every year by the tax administration. Therefore, the State makes the distribution, and the amount to receive will be given by the number of pensioners. That is, these people of retirement age only have an expectation to receive a pension according to the financial possibilities of the Social Security budget in Spain, which can be increased according to the consumer price index or decrease according to the collection efficiency of the system itself. As a result, there is no certainty of the amount of money each elderly will receive.

In addition, this is a system that can be changed from the regulations by internal Social Security decisions. In other words, the government depends on how well they did every year in tax collection. From the foregoing, it can be deduced that the amount that will correspond to each adult senior citizen of retirement age is the result of dividing the expectation of the total amount of the Social Security fund by the number of possible pensioners, and according to this figure is decided what will be the percentage of distribution.

Dueñas et al (2011) states that the most important current legislation regulating Social Security is included in Royal Legislative Decree 1/1994, which approves the consolidated text of the General Law of the Social Security and in Royal Decree Law 36/1978, on institutional management of Social Security, Health and Employment. Article 160 establishes that the economic benefit due to retirement, in its contributory form, will be unique for each beneficiary and will consist of a life annuity that will be recognized, under the conditions, amount and form that is regulated by law (p.374).

The capitalization method is a method adopted in some European countries copied from the Chilean model. This method is very different from the hedging capital distribution method, since it works as a form of individual savings through a national account, where the contributions with their respective interests are paid annually. Thus, the pensioner will know the contributions and interest earned during his working life. Another very important feature of this system is that it depends on the degree of risk of the investment program in the financial markets.

That is, the riskier the investment in the different income instruments, the interest is higher, as well as the probabilities of loss. In times when interest increases due to market behavior, logically the remuneration to the capital that the future pensioner contributes is greater. On the contrary, if in the capitalization system when the person is going to retire the interest earned has been affected by low returns on the investment, their expectation will be lower. Then, the retiree will never receive the same income, which violates the right of equality.

Regarding the mixed method, in some countries the distribution system has been combined with the capital system, considering the characteristics of the pay-as-you-go system and the characteristics of the capitalization system to ensure greater coverage for people of retirement age. In Spain, the possibility of implementing this method to reduce the lack of resources in this public system is being studied. However, the latest reforms have only modified the retirement age and working time per person since there was no consensus between the Government, employers and unions.

In this regard, the age of retirement was raised from 65 to 67 years through a gradual period for its entry into force. In the same way, the years of work will be increased from 35 to 37 years by 2027 for those who retire at 67; those who have contributed for 38.5 years may retire at 65, charging the entire pension. The workers will be able to continue retiring in advance, although the Government tries to harden this faculty because of the increasing of the elderly. Eventually, the system will collapse for lack of funds and resources.

B. Financing foundation of the Public Pension System in Spain

Article 87 of the General Law of Social Security states that the financial system of Social Security is that of distribution. That is to say, the economic sectors of prosperity must be compensated with the depressed sectors, so young people are subject to sacrifices with respect to the old ones. Like the Colombian pension system, the Spanish pension system is also based on the principle of solidarity. However, this principle has a different interpretation in the Spanish context (Dueñas, et al, 2011, p.379).

According to Dueñas et al (2011) there are three different axes in which solidarity moves in the Spanish legal system: solidarity between generations, solidarity between assets with respect to liabilities, solidarity between different territories or between autonomous communities, named by the Spanish Constitutional Court as “territorial solidarity” (p.391). About solidarity between generations, it is understood that the group of inhabitants who today are of retirement age will receive an old-age pension thanks to the contributions of the generation of active workers.

On the other hand, the solidarity between assets and liabilities describes the obligation of the public administrator of the budget of public pensions to ensure their sustainability and efficient use of resources. Territorial solidarity is defined by the economic capacity that a territorial entity may have to solve the liquidity problems of the system. This ark is the General Treasury of Social Security, where all the money that comes from social security is saved through the monthly payments paid by companies and workers. From there, it is taken out to subsidize unemployment and public pensions.

In addition, in the third preamble of Law 27 of 2011, clear public policies are created regarding the fundamental rights of social protection and the sustainability of the Spanish pension system, recognizing not only the need for constant structural reform system but a financial stability that allows a greater coverage according to the growth rate of the population of the older adult. Lately, the public pension system in Spain has reported an increase of 16% in the use of financial resources, represented by more than 16 billion Euros.

This system has reported sustainability problems during the last 7 years, since the way it was conceived does not allow considering that by 2050 there will be twice as many people of retirement age than what is currently registered in the system. of data and government statistics. The answer to the above has been to promote a legislative reform that extends the working life of the worker and reduces the percentage of distribution of the pension. The problem reducing this social benefit is that no sector of the Spanish society is willing to renounce to a pension in whole or in part.

The problem lies in the burden of its distribution system. "At first, the distribution system is attractive and apparently advantageous. In laboratory conditions, it would not have to fail. When the chain starts, resource flows are plentiful. Everyone contributes and nobody retires. Revenue is high and payments are very low. However, time passes, and we must start paying for committed pensions "(Piñera, 1990, p.7). Then, the pay-as-you-go system is bound to collapse. Here, the public policy would be to implement a private savings fund that would decongest the system of distribution of coverage capital.

Now, in the different sectors of the country and the autonomous regions, there is no will to end the public system and much less to bet on a single system of individual savings that is directly influenced by the stability of the stock market. However, the figures rush to a government that is unable to create a clear public policy to address the crisis of the public pension system. The more than 10 million pensions that the government calculates that will be for next year will be divided by 9.3 million contributory pensions, 440,000 non-contributory pensions and 185,000 family benefits.

Obviously, the distribution system has the greatest burden. This burden is projected in a line of growth that affects the sustainability of the public fund. The public pension system is suffering economic solvency, and it is feared that retirees by 2030 will charge only a maximum pension of 1,400 euros compared to the 2,560 euros they currently charge. "Workers who, due to age imperatives, will shortly leave their working life to become retired live the economic situation of the country with some uncertainty without knowing well what awaits them in the near future" (Diario de burgos, 2015).

Among the proposals to confront the financial crisis in the public pension system is to design a better pension system based in encouraging individual savings over the equal pension to every elderly, so that there are no substantial reductions to pensions, much less to the level of private administration. This can be seen in countries such as France and Belgium, where the elderly pensioner has a maximum pension of up to 1,400 euros, and the amount can be raise depending on the savings throughout their labor life.

C. Tax treatment of pensions in Spain

The tax treatment of pensions in Spain is equal to the tax treatment of an income or personal work performance. For example, a person who works, his or her personal work performance is added to the other income of the general base income. Now, there are three ways to rescue a pension plan to avoid increasing the base. First, the rescue in the form of capital means that, if the entire one-time amount corresponding to the pension was collected, all the consolidated rights that have been acquired throughout the working life, there would be a small fixed bonus.

This fixed bonus was that the amounts received before January 2007 associated with these contributions have a reduction of 40%, but after this date there will be no reduction. The rescue in the form of income consists of the total distribution of the amount of pension between the number of years; that is, the pensioner will receive a pension on a monthly, quarterly, or annual basis, and the tax will be deferred according to the period of payment of the adult. Here, in this second option, the pensioner will be able to rescue what is pending at one time.

And second, the mixed rescue consists of acquiring part of the pension in the form of capital and another in the form of income, each having its tax form as established above. In addition to what was previously stated on the taxation of pensions, personal work expenses will be deducted from the general income base. Likewise, in the Spanish legal system, in Law 27 of 2011, which deals with updating, adaptation and modernization of the Social Security system, the issue of the pension tax is addressed, in additional provision thirty, in accordance with the Toledo Pact.

This pension tax mechanism has been postponed six times to date, revealing a skepticism of the general population. However, it should be noted that, in this same law, regulations are created for collective dependency insurance in accordance with the provisions of the first additional provision of the Consolidated Text of the Law for the Regulation of Pension Plans and funds, whereas the policyholder, the company will be exclusively included and the status of insured and beneficiary will correspond to the worker, which allows incentives for individual savings.

At the same time, it is recommended, as in Colombia, to diversify the sources of financing pensions through private savings systems, by means of laws that make the private savings model more attractive and self-sustainable next to the public pension system, able to offer even better service than the public one. Spanish citizens have become accustomed to the fact that the public pension system is under the headings of the General State Budget, where there are sufficient funds for the total coverage of older adults entitled to receive a pension or similar financial assistance.

On the other hand, the coverage of private pensions, which covers 54% of the active population, is relatively high compared to other countries, but the contributions of its members are still low. About 66% of participants contribute less than 300 euros per year. The low level of contribution to private pensions that has prevailed so far could also reflect the high level of provision offered by the public system (OECD, 2011, p.13). That is, the public pension system has not been clear in revealing its true economic situation to the Spanish people. A financially unbalanced system.

The general perception is that government has the necessary resources to make the distribution of the fund among the total number of pensioners who have the right to enjoy a pension. In short, Spain has already begun the process of restructuring the public pension system, signing political agreements such as the Toledo Pact, which is an instrument of socio-political consensus, through which the needs of the population are studied and highlighted. Currently, the method of distribution must be rethought and redesigned.

"The day will inevitably arrive - as it seems it has already arrived in Italy - in which the State will not be able to pay the promised pensions, which will imply a huge social crisis" (Piñera, 1990, p.7). This means that there is a call for all countries to change their pension system because there is an imminent growth in the elderly population as well as there are less people working nowadays to support the system. In conclusion, sustainability and coverage problems can only be solved with the right design of pension system, where everyone contributes to its solvency.

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