REPORT ON THE EVALUATION OF THE PENSION EXPENDITURE RULE

EXECUTIVE SUMMARY

March 31st, 2025

Independent Authority for Fiscal Responsibility

The mission of the Independent Authority for Fiscal Responsibility, AAI (AIReF) is to ensure strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

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Publication date: March 31st, 2025

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The Independent Authority for Fiscal Responsibility (AIReF) must report before April 1st on the estimated impact of the measures adopted in the pension system from 2020, as provided for in Royal Decree Law 2/2023[1], of March 16th, 2023. This royal decree-law establishes that, from 2025 and every three years, AIReF will publish and submit an Evaluation Report to the Government with projections of the estimated impact of the measures adopted from 2020 to strengthen the revenue of the public pension system in the period 2022-2050 and calculate the average annual impact of these measures as a percentage of Gross Domestic Product (GDP) for this period, using the same macroeconomic and demographic assumptions as the latest Ageing Report published by the European Commission.

AIReF only has to estimate the impact of the average revenue measures for 2022-2050 and verify whether the estimated expenditure for the same period in the European Commission's Ageing Report minus the impact of the measures exceeds 13.3% of GDP.

[1] Royal Decree-Law 2/2023, of March 16th, on urgent measures to extend the rights of pensioners, reduce the gender gap and establish a new framework for the sustainability of the public pension system.

This report is presented together with the second edition of AIReF's Opinion on the Sustainability of the General Government[2], as committed to in the Opinion on Sustainability published in 2023.

AIReF considers that the Opinion addresses sustainability from a comprehensive and independent perspective, as opposed to the partial and limited approach of the pension expenditure rule introduced by Royal Decree-Law 2/2023 of March 16th, 2023.

As regards the methodology, the Opinion encompasses long-term demographic, macroeconomic and fiscal forecasts prepared by AIReF independently according to its own assumptions and methodology, incorporating the latest available information, which allows for the evaluation of the sustainability of the GG Sector. In contrast, the pension expenditure rule limits the assumptions and results of the pension expenditure forecasts to those published in the Ageing Report of April 2024 - based on demographic and growth projections that were published in November 2023 with 2022 population data. These assumptions are agreed by the Member States and the European Commission and are obtained by applying methodologies and hypotheses common to all countries, without fully incorporating the specificities of each of them, something that AIReF does in its Opinion.

Given the time that has elapsed since the demographic and growth assumptions were made, it has been necessary to link the most recently published official information and the rates of growth of expenditure on pensions and nominal GDP from the Ageing Report. The potential inconsistencies that arise from making expenditure projections with outdated demographic assumptions would be avoided if AIReF's projections were used. Experience shows that the time of the evaluation of compliance with the expenditure rule and the information that is incorporated is crucial in determining the result. In this regard, in the Report on the Pension Expenditure Rule, AIReF is only responsible for estimating the impact of revenue measures, and always under the assumptions of the Ageing Report.

Even more importantly, the pension expenditure rule implies a limited concept of sustainability as it refers exclusively to the Social Security system and establishes a quantitative reference - a limit on expenditure net of revenue measures of 13.3% of GDP - which is not anchored in the principles of sustainability, sufficiency and intra- and inter-generational equity that should guide the design of a pension system.

[2] Opinion on the Long-term Sustainability of the GG: demography and climate change

This level of net expenditure is the result of an agreement between Spain and the European Union within the framework of the implementation of the Recovery, Transformation and Resilience Plan, with the aim of limiting the increase in pension expenditure in a period of strong pressures associated with the retirement of the baby boom generation. According to AIReF, in no case can it be considered that maintaining net expenditure at around that reference level constitutes an adequate indicator of the sustainability of the pension system, much less of the public sector as a whole.

Accordingly, although the purpose of the expenditure rule according to Royal Decree-Law 2/2023 is to establish a mechanism by which AIReF "will report to the Government on the impact of the measures adopted in order to guarantee financial sustainability", AIReF considers that compliance with the expenditure rule or the closure clause cannot replace a complete and detailed analysis of the implications of ageing on the forecast for expenditure on pensions and the impact of the reform measures implemented in terms of the debt path (sustainability), sufficiency and inter-generational equity, something that is performed in AIReF's Opinion, especially when these implications may mean that transfers from the Central Government (CG) need to be increased throughout the projection horizon.

However, and in compliance with its mandate in the context of assessing compliance with the expenditure rule, taking the demographic and macroeconomic assumptions of the Ageing Report, AIReF estimates that the average annual impact of the measures adopted from 2020 to strengthen the revenue of the public pension system is 1.4% of GDP in the period 2022-2050.

The measures considered in this estimate are the Inter-generational Equity Mechanism (MEI), the evolution of the maximum contribution bases, the additional solidarity contribution, the reform of the Special Regime for Self-employed Workers (RETA), State transfers to the Social Security system to strengthen the revenue of the public pension system, and the permanent or structural impact on the system's revenue of increases in the minimum wage and labour reform measures.

TABLE 1. AVERAGE ANNUAL IMPACT OF MEASURES ADOPTED FROM 2020 TO STRENGTHEN REVENUE OF PUBLIC PENSION SYSTEM IN PERIOD 2022-2050 (% GDP)

	Impact to date	Average impact 2022-2050
Change in revenue	**0.8**	**1.4**
Inter-generational Equity Mechanism	0.2	0.4
Evolution of the Maximum Contribution Base	0.2	0.3
Additional Solidarity Contribution	-	0.1
Reform of Contributions for the Self-Employed	-	0.2
Transfers	0.2	0.3
Increases in the Minimum Wage	0.1	0.1
Labour Measures	-	-

Source: AIReF

Although the average annual impact of the revenue measures is 0.3 points lower than 1.7% of GDP - the reference value established in Royal Decree-Law 2/2023 - average gross public expenditure on pensions in the period 2022-2050 in the latest Ageing Report updated with the latest observed data stands at 14.6% of GDP, 0.4 points below the limit of 15% of GDP. The successive upward revisions in the level of GDP made by the National Statistics Institute go a long way to explaining the downward revision in the level of expenditure expected in that period compared with the content published in the Ageing Report in April 2024, of 15.4% of GDP. AIReF's own estimates, published in the Opinion accompanying this report, place average expenditure at a somewhat lower level, 14.4% of GDP over the same period.

Accordingly, AIReF confirms that the limit established in the Second Additional Provision of Royal Decree-Law 2/2023 has not been exceeded, as pension expenditure net of revenue measures is 13.2% of GDP on average for the period 2022-2050. However, in dynamic terms, there is no evidence of an improvement in the public pension system. Specifically, AIReF's 2023 forecasts assumed an increase of 3 points of GDP between 2022 and 2050, rising from 13.2% of GDP in 2022 to 16.2% of GDP in 2050. At present, AIReF's forecasts assume an increase in expenditure of 3.4 points of GDP between 2022 and 2050, rising from 12.7% in 2022 to 16.1% of GDP in 2050. Consequently, the pressure of expenditure on pensions is 0.4 points higher than in the 2023 Opinion.

This dynamic of expenditure on pensions, together with the expected evolution of contributions, which are estimated to increase by 1 point, reaching 10.1% of GDP, implies that over the projection horizon it will be necessary to increase transfers from the rest of the Social Security Funds or from the CG by 2.4 points of GDP. This increase, in the absence of measures, will mean a reduction in the revenue available for the financing of other expenditure policies or the need to resort to borrowing, which is difficult to reconcile with the demands and commitments stemming from the European and national fiscal frameworks.

Taking into account the weaknesses described in the definition and implementation of the pension expenditure rule, AIReF makes a recommendation to the Ministry of Inclusion, Social Security and Migration that, in the process of adapting the national fiscal framework to the new European framework, it should integrate the pension expenditure rule, aligning it with the targets and deadlines of both the European and national fiscal frameworks.