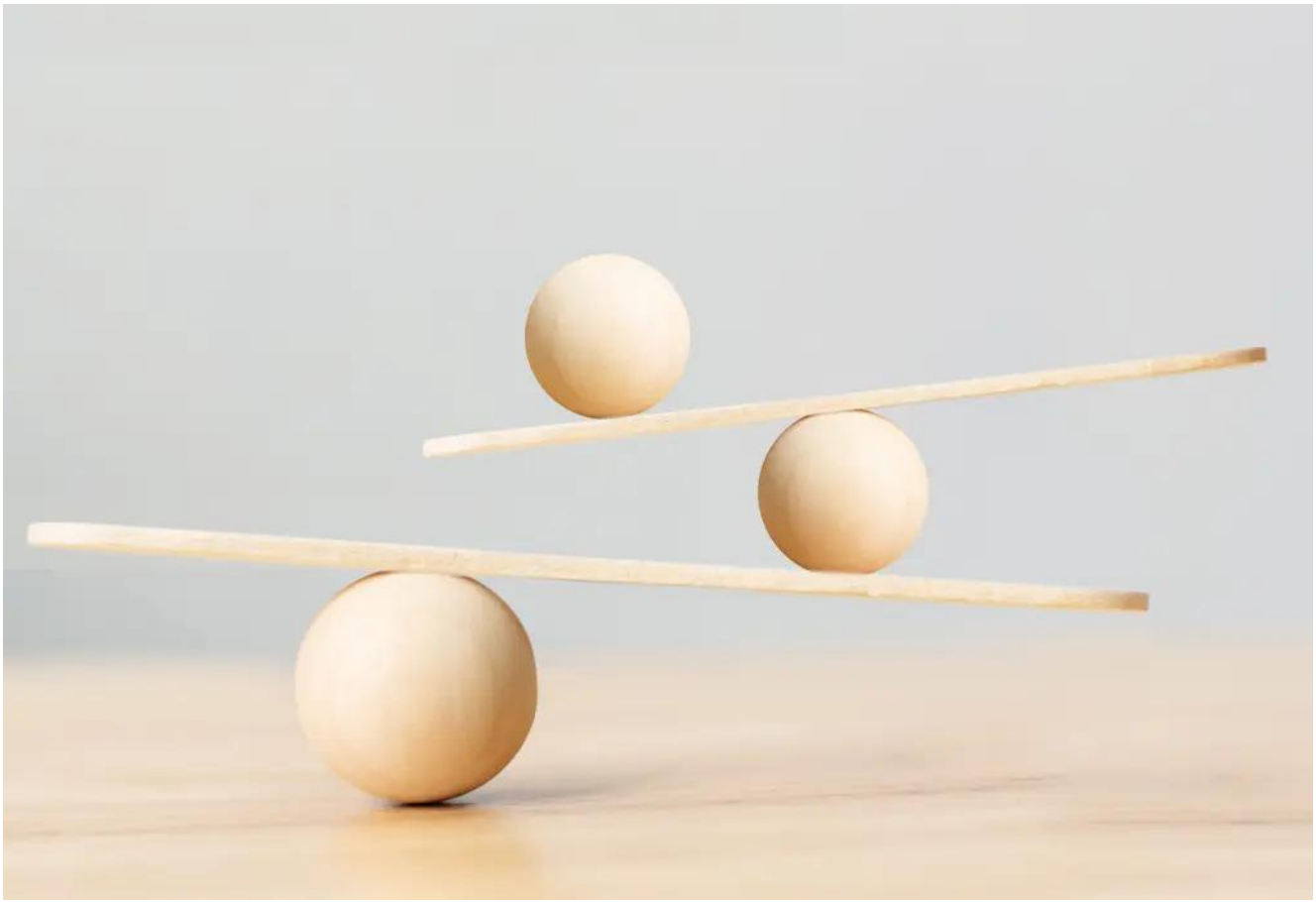
Why the new Spanish pension reform is unsustainable

Simulations to 2070 using the new model show that the 2025 pension adjustments worsen the system instead of easing it.



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By Javier Diaz-Gimenez

The Spanish pension reform that came into effect in April 2025 marks a new attempt to

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secure the future of the public pension system. But after thoroughly examining it, I fear this effort won't be enough.

Two decades of reforms, adjustments and corrections have led back to the same stumbling block. And according to a model I developed with Julian Diaz-Saavedra, the latest reform, approved between 2022 and 2023, doesn't just fail to solve Spain's pension woes, it actually exacerbates them.

Our study shows that the measures designed to secure the future of the system have minimal effect and that, in the long term, they could have serious fiscal and distributional consequences.

In search of a sustainable pension model

The reforms of 2011 and 2013 moved Spain toward a more sustainable retirement pension model, although at the cost of reducing the real value of pensions.

In 2021, Pedro Sanchez's government reversed these reforms, eliminated the sustainability factor and the revaluation index, and returned to updating pensions in line with the Consumer Price Index (CPI). This counter-reform substantially increased the cost of pensions and once again called into question the system's sustainability.

To compensate for the resulting deficit, subsequent parametric reforms modified the following characteristics of the system:

- **The Intergenerational Equity Mechanism (MEI by its Spanish acronym),** which raises the contribution rate by 0.6 percentage points in 2023 and gradually increases it to 1.2 points in 2029, where it will remain permanently. The additional revenue generated by the MEI is accumulated in a reserve fund intended to offset the imbalance between contributions and pension expenditure. Contrary to all economic logic, this fund is entirely invested in Spanish public debt.
- **The annual bonus** for each year worked beyond the normal retirement age increases from 2% to 4%.
- **The increase in the maximum contribution ceiling and the maximum pension:** the former will grow by 1.2% annually between 2024 and 2050, while the maximum pension will grow by 0.1115% annually during the same period.
- **The "solidarity quota,"** an additional contribution on earned income exceeding the maximum contribution**.**

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- **The minimum retirement pension** must reach 60% of median income by 2027.

Effects of the 2025 Spanish pension reform

To assess the impact of these reforms, we used an overlapping generations model that simulates the Spanish economy until 2070, projecting demographic, economic and tax trends.

The result is unequivocal: These reforms won't restore balance in the system, and they won't be sustainable. According to our simulations, pension spending will rise from 12.9% of GDP in 2022 to 17.7% in 2050, while revenues will remain virtually unchanged. In that same year, the deficit will reach 6% of GDP, and if financed through consumption taxes, the VAT rate would have to rise by more than 12 points, to around 30%.

Who will suffer the most?

The impact of these measures is uneven. Higher-income workers, especially younger ones, are clearly disadvantaged: They pay more in contributions, receive proportionally less and don't benefit from the increase in the minimum. Lower-income workers, on the other hand, see a slight improvement thanks to the increase in minimum benefits and a slightly lower VAT rate. Overall, higher-income workers — mainly younger and more educated workers — will suffer welfare losses equivalent to 0.3% of GDP, or around €4.5 billion in 2025.

How to build a truly sustainable pension system

All of this leads to a conclusion that is difficult to avoid: Reversing the 2021 reforms was a mistake. That decision has led us to waste two decades that could have been used to implement structural reforms capable of addressing the country's demographic and economic challenges.

We believe that Spain needs three lines of action:

- First, it should reinstate automatic adjustment mechanisms that link pensions to life expectancy and the financial balance of the system.
- Second, it should supplement the public system with mandatory individual accounts

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that encourage pension savings and reduce pressure on the pay-as-you-go system.
- Third, it should accompany the reforms with compensatory measures or tax incentives that make the changes politically viable and socially acceptable.

Other European countries have followed this path. Sweden, for example, combines a fully sustainable public pension with notional individual accounts, and Italy and Latvia apply automatic sustainability factors. Spain could also do this, but it requires a correct diagnosis of the system's problems, the political will to solve them and a long-term vision.

The aging of the population is an undeniable fact, and the data is unforgiving. Every year without structural reform increases the future cost and makes consensus more difficult. We need comprehensive reform to ensure a sustainable and equitable pension system.

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