



# The Reforms component of Spain's Recovery Plan

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# The Reforms component of Spain's Recovery Plan\*

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## 1. Introduction

In a special meeting of the European Council held in July 2020, European leaders reached an agreement on a new multiyear financial framework for 2021-2027 and on a package of extraordinary measures to support the recovery from the deep crisis caused by the Covid-19 pandemic.<sup>1</sup> These measures would be articulated through a recovery fund, known as *Next Generation EU (NGEU)*, to be executed between 2021 and 2026. The instrument would channel around 750,000 million euros (at 2018 prices) in grants and loans to EU member states, favoring the poorer countries and those that were worst hit by the crisis.

To mitigate the economic and social consequences of the pandemic, these resources would be used to finance investments and reforms designed to set the basis for robust and sustainable growth, with special attention to supporting the digital and green transformations. To be eligible to participate in the program, EU member states would have to prepare *Recovery and Resilience Plans* detailing their investment and reform proposals. The European Commission would then assess these plans on the basis of their coherence with these priorities and their consistency with the specific recommendations addressed to member states within the framework of the European Semester in recent years. The disbursement of the funds would then be conditional on the satisfactory fulfillment of the established objectives within the agreed time frame. (EP&CEU, 2021, arts. 18, 19 and 24).

Over the following months, EU member states prepared, negotiated and launched their Recovery Plans. The Spanish Plan was submitted in October 2020 and approved in July 2021 by the EU Council, with a financial contribution of 69,500 million euros in grants. An addendum to the Plan was presented in June 2023 and was approved by the European Commission and the Council in October of the same year. The revised Plan includes an additional 10,300 million euros in grants and 83,000 million in loans. The Plan also includes a detailed listing of 140 investment targets and 111 reform milestones that must be fulfilled to the Commission's satisfaction before disbursements can be made.

NGEU has two noteworthy novel features. One is that, breaking a long-standing taboo, it will be financed through the emission of mutualized debt issued by the European Commission on behalf of the entire EU. To finance and repay this debt (by 2058) the EU will have to find new "own revenue" sources. Another novelty is that, unlike most European funds to date, the Recovery Fund will disburse its resources following a *pay for performance* criterion, rather than simply reimbursing spending on authorized programs and investment projects. Performance, moreover, will be partly measured in terms of the implementation of reform measures that are expected to have long-lasting positive effects on growth, equity or sustainability. Hence, NGEU funds will be used to incentivize structural reforms.

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<sup>1</sup> See <https://www.consilium.europa.eu/en/press/press-releases/2020/07/21/european-council-conclusions-17-21-july-2020/>

The two features may be seen as parts of a negotiated package. Since the burden of debt servicing and repayment will fall disproportionately on the richer EU countries, an ambitious program of structural reforms that will increase the growth potential of poorer countries and help improve their public finances may be a reasonable *quid pro quo* for the transfer implicit in debt mutualization-- provided it helps increase this second's group contributions to the EU budget in the future, or at least reduce their need for further assistance. For the bargain to be satisfactory for both parties, and hence susceptible of repetition in the future, it is important that the reform programs be well designed and correctly executed.

This paper asks to what extent this is happening in the case of the reforms contained in the Spanish Recovery Plan. Over the last two and a half years, Spain has approved a large number of reforms, some of them of great economic and social importance, generally respecting the deadlines established in the Annex to the Plan, although often at the expense of an excessive use of urgent legislative procedures that may have reduced their quality. The following section lists the main reforms contained in the Spanish Plan and checks whether their stated objectives are in line with NGEU's requirements. The rest of the paper will then look more closely at the content of some of these measures, and at the Commission's assessment of them.

My conclusion is that, from the point of view of the objectives of NGEU, the balance of the reform program contained in the Spanish Recovery Plan has been spotty up to now, with some important reforms pointing in the wrong direction and some others lacking ambition. The Commission's reports, however, have mostly ignored the problematic features of the new legislation, with one important exception that served as a reminder of the need to balance the books of the public pension system. In the following months, the Commission will have to pronounce itself over the just completed pension reform and about some other important measures, like the new housing law. It will be doing both Spain and Europe a disservice if it does not raise its voice against ill-conceived measures and fails to push for a course correction to take full advantage of NGEU's potential to strengthen the Spanish economy.

## **2. The reforms component of the Spanish Recovery Plan: an overview**

As has already been noted, Recovery and Resilience Plans must be consistent with the country specific recommendations (CSRs) addressed to EU member states in the context of the European semester in recent years. Box 1 lists the most important such recommendations for the case of Spain. They concentrate on fiscal sustainability, with special attention to the pension system, reinforcing social protection and improving labor market performance and educational outcomes.

### **Box 1: Main country specific recommendations to Spain (2019 and 2020)**

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#### **• Fiscal sustainability**

- Pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability,
- Preserve the sustainability of the pension system.

#### **• Social protection**

- Improve coverage and adequacy of minimum income schemes
  - Improve support for families
  - Ensure that social services have the capacity to provide effective support.
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## Box 1: continued

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- **Labor market**

- Foster transitions towards open-ended contracts, including by simplifying the system of hiring incentives.
- Ensure that employment services have the capacity to provide effective support.
- Support employment through arrangements to preserve jobs, effective hiring incentives and skills development

- **Education**

- Reduce early school leaving and improve educational outcomes
  - Increase cooperation between education and businesses with a view to improving the provision of labour market relevant skills and qualifications, in particular, for information and communication technologies.
  - Improve access to digital learning.
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- Source: CEU (2019 y 2020)

Box 2 lists the major reforms included in the Spanish Recovery Plan and their stated objectives. Comparing the contents of both boxes we see that, at least in principle, the proposed reforms are indeed consistent with the CSRs. In both cases, the focus is on the improvement of labor market performance, educational outcomes and social protection, while preserving the sustainability of public finances. As we will see below, however, some of the measures that have been approved so far as part of the Plan are not consistent with their stated objectives or fail to pursue them in an effective or efficient manner. For future reference, I have underlined in Box 2 those stated objectives for which the tension with implemented measures is greater.

## Box 2: Major reforms included in the Plan and their stated objectives

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- **Labor market:** Its main objectives are to reduce structural unemployment and youth unemployment, reduce the widespread use of temporary contracts and correct labour market duality, increase investment in human capital, modernise collective bargaining instruments and increase the effectiveness and efficiency of active labour market policies (p. 210).
  - **Social Protection:** “The focus shall be on ensuring appropriate coverage depending on the circumstances leading to vulnerability and ensuring adequate income support, thereby contributing to poverty reduction. To this end, it shall take into account the structural needs of households, notably families with children and people with disabilities. It shall also link income support to active job seeking, in order to foster socio-economic integration and avoid poverty traps.” (p. 204).
  - **Pensions:** “The objective ... is to reform the pension system in order to i) ensure the financial sustainability of the system in the short, medium and long term, ii) maintain the purchasing power of pensions, iii) preserve the adequacy of pensions, iv) protect pensioners from poverty and v) ensure intergenerational equity.” (p. 256). The Council Decision approving Spain’s original plan leaves a considerable leeway for the final form of measures to be negotiated with the social partners but warns that the final design of the reform “should be compatible with the medium- to long-term fiscal sustainability of public finances.” (CEU, 2021a, p. 14)
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## Box 2: continued

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- **Fiscal Reform:** “The objectives pursued by the reform of the Spanish tax system are to make it more equitable, progressive, sustainable and fair, while deepening the design of green taxation, incorporating a gender perspective .... The reforms also aim at contributing positively to economic growth, job creation, economic resilience and inter-territorial cohesion. As the overall ratio of tax revenue to GDP in Spain is lower than in peer economies, there is scope to raise revenues and foster the medium and long-term sustainability of public finances.” (p. 244).
- **Housing:** “The objective of this measure is to implement, by means of the Housing Law, a first of a kind regulation in Spain, to address the various public planning, programming and collaboration instruments already in place to support the right to decent and adequate housing. It shall address the rehabilitation and improvement of the existing housing stock, both public and private, and regeneration and renewal of the residential environments in which they are located, to improve the quality of life. The law addresses the achievement of a sufficient level of housing stock for rental property, available at affordable prices.” (p. 16).
- **Education:** “This component of the ... plan focuses on modernising the education system and improving education infrastructure. It aims at a more flexible and inclusive system better tailored to the needs of each pupil and introducing new teaching and learning techniques, including digital. (p. 193)

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- Source: CEU (2021b), unless noted otherwise.

The preliminary record of the reforms component of the Spanish Recovery Plan is mixed. While improving social protection has probably been the first priority of the current Government, good wishes have not always translated into effective policies and fiscal sustainability considerations have not received the attention they deserve. A sorely needed minimum income scheme (IMV, for its Spanish initials) has been introduced to combat poverty (BOE, 2020), but its rollout has been greatly slowed down and its effectiveness compromised by the decision to have the central Government manage it, rather than the autonomous communities that were already running supplementary income programs and manage the employment services whose collaboration is essential to avoid turning the IMV into a poverty trap. In the same line, it has taken over two years to introduce (in BOE, 2022b) incentives to accept employment offers without losing benefits, thus bringing the scheme’s effective marginal tax rate below its initial value of 100%.<sup>2</sup>

Progress has also been made in reducing labor market duality through an important legal reform, negotiated with the social partners (BOE, 2021b), that greatly restricts the use of temporary contracts, slightly increasing outsiders’ bargaining power, and modifies some aspects of collective bargaining in favor of unions while preserving firms’ ability to adjust to negative shocks. The reform has greatly increased the share of open-ended contracts, thereby dramatically reducing what may be called “contractual precariousness,” but has had little effect so far on average contract durations and wages (Felgueroso and Doménech, 2023 and Conde Ruiz et al, 2023). There has also been little real improvement in the functioning of the public employment offices that run intermediation services and manage active labor market policies, in spite of a new employment law that introduces mostly cosmetic changes (BOE, 2023c).<sup>3</sup> In the area of education, there has been a significant legislative and budgetary effort, with

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<sup>2</sup> For a more detailed analysis of IMV, see section 4.1 of Felgueroso and de la Fuente (2020) and Appendix 7 to de la Fuente (2022).

<sup>3</sup> For a more detailed analysis, see Appendix 1 to de la Fuente (2022) and the references listed there.

revisions of several basic laws and ambitious investment plans, but there have also been complaints that the new legislation pays insufficient attention to the quality of education (Gomendio, 2023).

As for tax reform, the report of the expert committee established in the Plan was published in February 2022 (Ruiz Huerta et al, 2022) but there has been no attempt so far to implement any of the (mostly sensible) reforms proposed in it, a task that should in principle have been completed by the first quarter of 2023. Aside from tinkering with indirect taxes on energy and foodstuffs to lower measured inflation and alleviate its effect on household budgets, substantive tax measures during the last two years have been largely limited to the introduction of new *ad hoc* levies on certain large corporations in the energy and financial sectors and a supplementary wealth tax, a set of measures not contemplated in the Recovery Plan.

The law establishing the sectoral levies is problematic on both procedural and substantive grounds. It has been rushed through Parliament in record time using a non-standard procedure to avoid all normally required reports by advisory bodies, such as the Council of State, and other quality filters on legislation initiated by the Government. The new taxes it creates, moreover, are highly questionable. The first one (the levy on banks and energy firms) is particularly worrisome as a threat to the rule of law, for it sets a very dangerous precedent that would essentially give the Government of the day the power to establish arbitrary levies on specific sectors or even firms, violating the principle of equal treatment of equals and the requirement that taxes reflect economic capacity (rather than its presumption or ideological biases against certain agents), as set out in the Constitution and the General Tax Law. The levy has little in common with the solidarity tax on the measured extraordinary profits of energy companies contemplated in CEU (2022) and should be reformed to bring it into accordance with this Council Regulation, which is often but wrongly cited to justify it.<sup>4</sup>

The supplementary wealth tax also raises complicated issues. In order to neutralize certain cuts in the wealth tax introduced by regional governments, it essentially reverses the assignment to these administrations of competences in the matter, acting in an opaque way that has brought forth constitutionality challenges by several autonomous governments. While the Central Government ultimately does have the constitutional power to regulate what continues to be a national tax (although “ceded” to the regions), the method used to do so is problematic. Competences over the tax have been transferred to the regions as part of a broader package that regulates the current regional financing system and has been ratified through bilateral agreements between the central and each of the regional governments. Since the new tax amounts to a change in the package imposed unilaterally by the Central Government, there may be grounds for a challenge before the Constitutional Court.

Other clear cases of misguided legislation under the auspices of the Recovery Plan have to do with the public pension system and with housing. The new pension legislation is a clear step backward in terms of the sustainability of Spanish public finances because it will considerably increase pension expenditure over the next decades without introducing significant compensating measures in terms of expenditure containment or revenue increases. The new housing law, in turn, is likely to considerably aggravate the scarcity of affordable rental housing

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<sup>4</sup> See de la Fuente (2022b) for more details.

that motivated its introduction. The following two sections will look in some detail at these two important reforms.

### 3. A questionable pension reform

One of the most important and controversial measures included in the Spanish Recovery Plan has been a comprehensive package of public pension reforms that have been passed into law between 2021 and 2023 (BOE, 2021a, 2022a and 2023a). The main measures are listed in Box 3, which includes brief descriptions of their content, stated objectives and possible shortcomings.

#### Box 3: Main measures included in the recent public pension reform

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- ***Repeal of the pension revalorization index and return to the indexation of all pensions to the CPI*** to guarantee their purchasing power. (p. 257)

- ***Repeal of the Sustainability Factor (SF)*** that would have reduced starting pensions to compensate for the effects of increases in life expectancy, to be ***replaced by a new intergenerational equity mechanism (IEM)***.

The design of the mechanism was not specified in the original Plan. Its first formulation (BOE, 2021) introduced a temporary increase of 0,6 percentage points in the rate of Social Security contributions between 2023 and 2032 to build up a reserve fund to help cover pension expenditure after 2033, and a vague commitment to do something if this was not sufficient in the future.

- *stated objective*: “to address the impact of the forthcoming demographic changes without worsening the adequacy of current and future pensions.” (p. 257)

- *problems*: The repeal of the SF will aggravate the system’s sustainability problems. The IEM will not improve intergenerational equity because it continues to increase the tax burden on the young in order to maintain the generosity of pension benefits and will be insufficient to guarantee the sustainability of the system, or even to replace the SF.

- ***Increased incentives for delaying retirement beyond the legal age and higher penalties to discourage early retirement.***

- *no objection*, but it is highly unlikely that these measures will generate the large savings in pension spending the Government foresees.

- ***Reform of the system of social contributions for self-employed workers.*** They will no longer be able to choose the level of their contributions, which will be based on their income from now on.

- *no objection*, but it is highly unlikely this reform will generate a large surplus during several decades, as the Government expects.

- ***Adjustment of the contributory period used for the calculation of the retirement pension***

- *stated objective*: “to reinforce the progressivity of the system and adapt the current regulation to discontinuous careers and other forms of atypical work” (p. 257).

- *problems*: it was expected that the computation period would be lengthened as a way to partially compensate for other measures that will increase pension expenditure, but the way it was done (allowing people to disregard the most unfavourable periods) will actually increase starting pensions and hence expenditure. It is questionable that the pension system should be progressive.

- ***Non-contributory and minimum pensions will be raised and linked to the poverty threshold.***

- *problems*: the Government seems to underestimate the cost of the measure.

- ***Measures to increase revenue***: Gradual increase of the maximum contribution base, coupled with a quasi-freeze of maximum pensions in real terms until 2050, new solidarity contribution on labor incomes above the maximum contribution base, increased IEM contribution (will rise from 0,6 percentage points in 2023 to 1,2 pp. in 2029 and remain in force until 2050).

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### Box 3: continued

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- *problems*: these measures will be insufficient to avoid sustainability problems and will reduce the contributory character of the pension system, partially turning social contributions from delayed compensation into a pure tax.

- ***New safeguard clause of the IEM***: Starting in 2025, the financial situation of the public pension system will be reviewed every three years using the Aging Report's projections of pension expenditure and AIREF's estimates of the effects of the recent reform on revenues. If expenditure net of additional revenues exceeds a certain threshold (in terms of expected average values over 2023-50) a semiautomatic adjustment mechanism will be triggered. Unless an agreement can be swiftly reached on alternative measures, social contribution rates will be raised to correct the imbalance in a maximum of five years.

- *Problems*: The threshold will be exceeded from the start. The mechanism is likely to force a sharp increase in social contribution rates which may have adverse effects on employment, and the threshold still allows a rather large basic deficit.

• ***“Separation of sources” of Social Security funding***

- *stated objective*: “to change the financing of the pension system ... so that contributory benefits are financed through social contributions and non-contributory benefits are paid from the state budget. The reform shall consist of the state taking over the financing of a number of expenditure items, which are currently covered by social contributions.” (p. 256)

- *problems*: There are few non-contributory benefits that were not already financed by government transfers since 2013, when the Government assumed the entire cost of minimum pension complements. Most of the new transfers cannot be justified with this logic and essentially serve to move the deficit from the Social Security budget to that of General Government, making the problem less visible and hence harder to solve.

• **MAIN PROBLEM: the reform can compromise the financial sustainability of the system and its intergenerational equity. The Government has published expenditure and revenue projections purporting to show the sustainability of the system is not at risk, but its calculations have been broadly questioned.**

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- *Source*: CEU (2021b)

The first stage of the reform involved the repeal of two automatic expenditure control mechanisms introduced as part of the previous reform: a rule for the revalorization of pensions that essentially froze them while the system was in deficit, and the so-called *Sustainability Factor*, which would have reduced starting pensions to compensate for increasing life expectancy (but was repealed before it went into effect). It is generally agreed that this first round of changes will put considerable upward pressure on future pension expenditure. There is no such agreement, however, regarding the extent to which other parts of the reform will help balance the system's accounts through expenditure savings or additional revenues. While the Government is very optimistic in this regard, most academics and private analysts are seriously concerned about the effects of the reform on the financial sustainability of the public pension system, or rather, about the danger that rapidly rising pension expenditure may leave Spain with little fiscal margin for almost anything else.<sup>5</sup>

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<sup>5</sup> See the Ministry of Social Security's projections of the revenues and expenditures of the public pension system (MISSMI, 2023) and the critical response prepared by a large group of academic experts (de la Fuente et al, 2023).



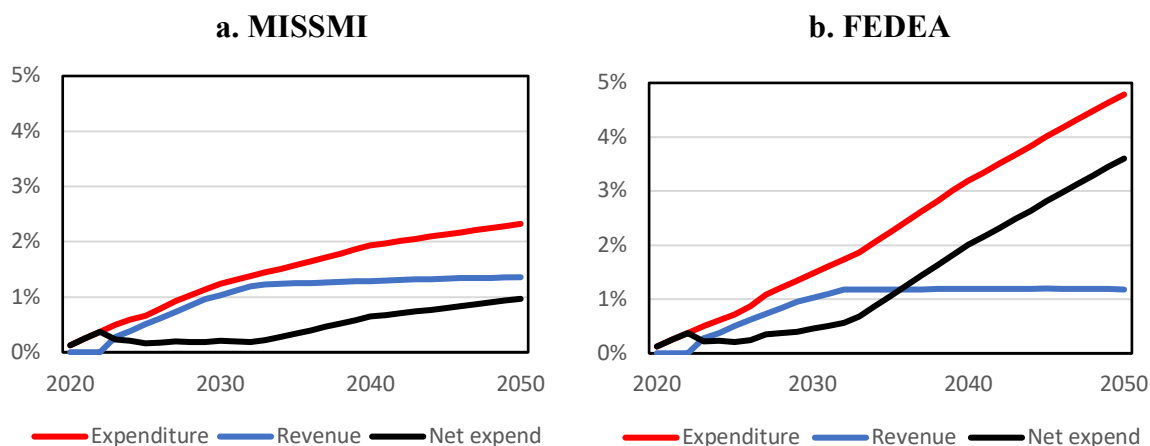
The Government's optimistic projections of the net financial effect of the reform rely heavily on its estimates of the budgetary implications of the recently legislated changes to the contribution system for self-employed workers and the strengthening of incentives for postponing retirement. While the measures adopted in these areas are quite sensible on their own right, a large majority of analysts find it extremely unlikely that they will generate the large savings or additional revenues the Government has penciled in in its reports. Among other problems, the Ministry's calculations, do not seem to take into account that both of these measures will have a delayed effect on expenditure through higher future pensions that will already be substantial in 2050, and are based, furthermore, on extremely optimistic assumptions regarding the take up rate of incentives for pension postponement and its effects on expenditure.

The reform was completed with a third package of measures that was approved in 2023. It includes some modifications in the calculation of the initial pension, a gradual increase in the maximum contribution base accompanied by the quasi-freezing of maximum pensions until 2050, the introduction of a solidarity contribution on labor incomes above the maximum contribution base and a revision of minimum and non-contributory benefits to increase their amounts and link them to the evolution of median income. It also includes a redesign of the (misnamed) Intergenerational Equity Mechanism (IEM) to introduce a gradual increase in social contribution rates and a safeguard clause to which I will return below. Against all expectations, the changes to the calculation of the initial pension were not designed to help contain expenditure but will actually increase it (by allowing retirees to disregard the months with the lowest contributions). All together, the new package can be expected to generate some net revenue gains, but not nearly enough to bring the system back into equilibrium.

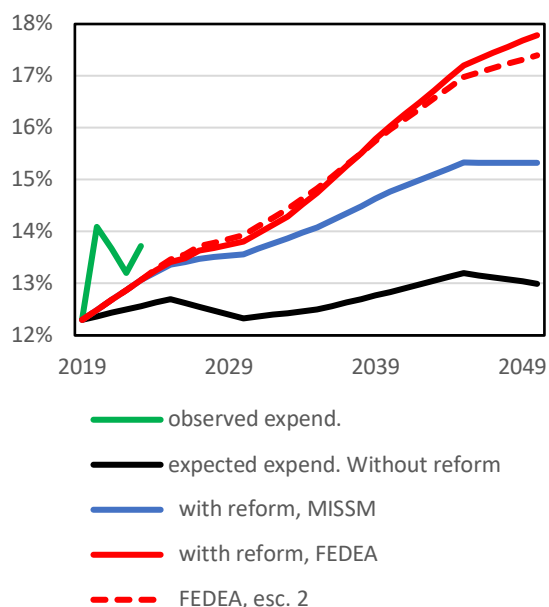
Over the last few years, the Government has reduced the official deficit of the pension system by greatly increasing its annual transfers to it. The official story is that this is just the completion of the long process of "separation of sources" through which the Government has gradually assumed the cost of non-contributory benefits which were previously financed by surplus social contributions. In fact, that process was essentially completed in 2013, when the Government assumed the full cost of the complements that bring contributory pensions to a guaranteed minimum level. The one significant exception to this has to do with the financing of certain reductions in social contributions that are used as employment incentives, but the cost of these subsidies (around 1,700 million in 2023) is only a fraction of Government transfers to the Social Security System, which increased by almost 20,000 million euros between 2019 and 2023 (de la Fuente 2023d, pp. 15-17).

To get a feeling for the magnitudes involved, Figures 1 to 3 compare the Government's projections of the public pension system's revenues and expenditures (in the absence of corrective measures) with an alternative based on the most recent edition of the EU's Ageing Report, that of 2021 (EC, 2021a), and my own estimates of the incremental effects of the reform published by FEDEA (see de la Fuente, 2023 a, b and c). As can be seen in Figure 1, while the Ministry of Social Security (MISSMI) expects that the reform, as a whole, will have only a moderate impact on the system's budget deficit, which would never exceed 1 percentage point of GDP, my calculations point to an increase of more than 3 points of GDP in the system's basic deficit (i.e. its deficit without considering Government transfers).

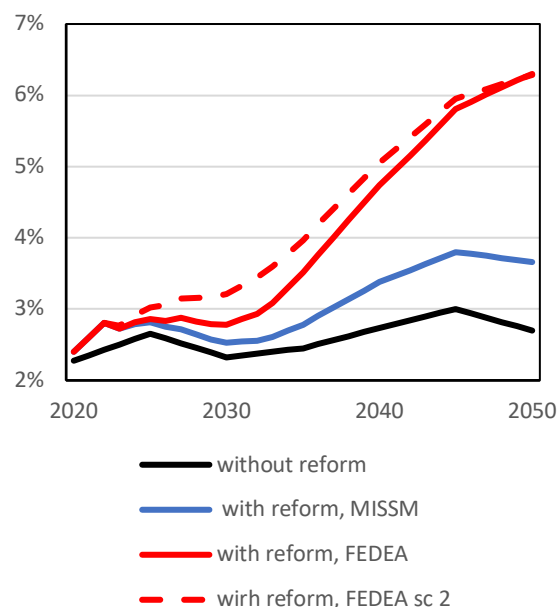
**Figure 1: Expected effect of the recent reform on the finances of the pension system  
Incremental revenue and expenditure and net impact as a % of GDP**



**Figure 2: Expected evolution of spending in public pensions, % of GDP**



**Figure 3: Expected evolution of the basic deficit of the public pension system**



- Source: de la Fuente (2023c)

According to my projections, total expenditure on public pensions (including those of civil servants and non-contributory benefits) would reach 17,8% of GDP in 2050, 2,5 points above the Ministry’s forecast (Figure 2). If we take as a reference the central scenario of the 2021 Ageing Report (EC, 2021a) for the rest of the EU, that figure would put Spain in the lead in terms of pension spending as a percentage of GDP, 5,2 points above the EU average and 1,6 points above Italy, which would take second place. The sharp increase in expenditure would also translate into an important increase in the basic deficit of the public pension system which, in the absence of corrective measures, would average 4,5 points of GDP during the period 2022-50 and reach 6,3 points in 2050 (Figure 3). Between now and 2050, that gap would absorb almost 40% of the State’s net tax revenue (excluding the participations of regional and local administrations in shared taxes), reaching 50% in 2050.

It must be kept in mind that the reform does introduce a quasi-automatic mechanism that will force the introduction of corrective measures if future official projections anticipate a sufficiently large increase in net expenditure. The mechanism takes the form of a safeguard clause introduced into the second version of the IEM (see Box 3) under pressure from the European Commission whose aim is to cap projected pension expenditure net of new revenue measures. Starting in 2025, the system will undergo a series of periodic reviews that will rely on the spending projections of successive Ageing Reports and on estimates of the impact of the reform's new revenue measures prepared by AIReF. If expected average expenditure over 2022-2050, net of expected average new revenues over the same period, exceeds 13,3% of GDP, the correction mechanism will be triggered, forcing, in the absence of a rapid agreement over alternative measures, an increase in social contribution rates to finance the estimated excess expenditure.

The consensus view among academic specialists (see de la Fuente et al, 2023), however, is that the safeguard clause would have to be activated right away, as the relevant condition would be satisfied with the most reasonable projections available today. It is also worrisome that its activation would still leave the public pension system with a rather large basic deficit that will considerably reduce the resources available to meet other priorities. With the projections summarized above, average pension expenditure between now and 2050 would be above 15% of GDP while the incremental revenues of the pension system generated by recent reforms would not exceed 1% of GDP. These projections would immediately trigger the safeguard clause, forcing a raise in social contribution rates of between 3 and 4 percentage points. This adjustment would help contain the system's basic deficit but would still leave it at an uncomfortably high level: 3,2% of GDP on average between now and 2050 and around 5% in 2050. These results suggest that it may be wise to reconsider a reform that would need important corrections from the very moment of its approval, even under fairly lax limits on the system's maximum basic deficit.

#### **4. The new housing law**

Another socially minded but problematic reform has been the approval of a new housing law (BOE, 2023b) that aims to “give content” to “the right to decent housing.” The attempt to make progress in this complicated question is likely to be not only unsuccessful but also counterproductive. Ignoring the lessons of both our own recent history and economic theory,<sup>6</sup> the norm chooses a set of policy options that will only aggravate the existing shortage of affordable rental housing, mostly by weakening private property rights over real estate.

As stated in the law's preamble and in its second article, a central objective of public housing policy must be to “facilitate the existence of an adequate and sufficient supply of housing that responds to the existing demand and allows the equilibrium of the market” (BOE, 2023b, p. 71.485). To pursue this objective, the new law sets out a series of instruments that include increased investment in the public stock of rental housing and fiscal deductions for income from private rentals, but also a more problematic set of options that will inevitably tend to worsen the supply problems the law presumably wants to solve. Among them is the possibility of introducing rent controls in areas considered “stressed” by local or regional authorities, the

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<sup>6</sup> See, among many others, López García (2019) and Arruñada (2022).

imposition of general limits on the actualization of rents and mandatory extensions of rental contracts in favorable terms after their expiration, as well as some provisions that make it complicated for owners to recover their property from delinquent tenants or illegal occupants. All these measures reduce the return to investment in residential real estate destined for rental or increase its expected risk, thus reducing its current and future stock through the withdrawal of properties from the market and a decline in investment in the construction of new units.

The law also contains imprecise language on the “social function” of housing property that weakens property rights over housing units and is likely to further discourage investment in the sector. In this line, the law’s preamble states that the constitutional right of citizens to have access to housing “modulates both property rights and free enterprise when they operate in the housing sector, from the double perspective of the social function of property and general interest” (BOE, 2023b, p. 71,479). Articles 1.2 and 11 introduce certain limits to and duties associated with the ownership of housing units, with a view to “guaranteeing the social function of property.” Article 1.2 refers to the *duty* of owners of housing units to “destine them to the habitational use foreseen by the law” and arts. 11.1.e, 19.1 and 19.4 to their “obligation to collaborate with the public administrations and supply information” on the use of their housing properties to “facilitate the increase of the supply of affordable rental housing.” While vaguely worded, these provisions can be interpreted in ways that would allow public administrations to impose unreasonable obligations on property owners, including that of renting their property at below market prices, or even the threat to have it expropriated to be destined to social uses, as has already been announced in Catalonia.<sup>7</sup>

Hence, the new law contains provisions that allow public authorities to expropriate without proper compensation part of the economic value of private property in order to finance what are seen as social policy measures. Even if we agree on the goodness of such measures (which is often questionable, as their beneficiaries are not always the needier parties), this is not a reasonable way to finance a public policy. If we decide that certain individuals need help to have a decent place to live in, the cost of the necessary aid should be shared by all in an equitable manner through the tax system. Hence, public administrations should assume the relevant costs in the first instance and then pass them on to society through general taxes. What should not be done is to arbitrarily force such costs, totally or partially, onto private parties that just happened to walk by. This way to proceed not only ensures an unfair distribution of the costs of such policies, but also hides them from the public’s view, invalidating the usual accountability mechanisms.

## **5. The Commission’s reaction**

As required by art. 24 of the RRF Regulation (EP&CEU, 2021), the European Commission has assessed Spain’s requests for payment on the basis of the fulfillment of the successive tranches of required targets and milestones. Three such requests have been submitted so far, the last one in November 2022, and all three have been approved by the Commission. So far, the Commission’s assessments of Spain’s progress in the implementation of its Recovery Plan (EC, 2021b, 2022 and 2023) have been quite benign. In many cases, the reports simply note that the relevant law has been passed, without looking carefully at its content and its possible

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<sup>7</sup> For a more detailed discussion, see Nasarre (2022) and de la Fuente (2023e).

shortcomings, and the Spanish Government's estimates of likely economic or budgetary effects are generally accepted without question.

The one significant exception I have found to this rule is in the Commission's report on Spain's second request for payment (EC, 2022, pp. 91-3) and has to do with some of the components of pension reform. As most analysts, the Commission's services question the Spanish Government's estimates of the pension savings generated by the new incentives to postpone retirement and the net effects of replacing the Sustainability Factor with the first version of the Intergenerational Equity Mechanism. The document warns of the danger of a widening gap between expenditures and revenues that would have to be corrected by adjusting the design of still pending reforms, citing in particular the expected extension of the computation period used to calculate starting pensions. These warnings disappear, however, in the third assessment report (EC, 2023), even though the discussion of the Government's estimates of the net effects of the new contribution system for the self-employed, also widely questioned in Spain, would have been a perfect occasion to reiterate them while the final components of the reform were being discussed.

As noted above, the expected extension of the pension computation period has not finally materialized but the Commission's concerns seem to be behind the revision of the IEM to introduce the semiautomatic safeguard clause discussed above, which may have dispelled the Commission's doubts. At any rate, we will have to wait for the report on the fourth payment request to know the Commission's assessment of the entire pension reform, including the Ministry's projections of its effects on revenues and expenditure until 2050, as well as its opinion on the new housing law. It is to be hoped that the Commission will not allow such questionable reforms to go through unchallenged and will push for corrections that will increase the sustainability of our public finances, our growth potential and the prospects for further advances in European integration. We are still on time to rectify.

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