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The financing of the Welfare System

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Introduction

In terms of Title VIII of the Constitution of 1978, the territory of the Spanish state is divided into seventeen Autonomous Communities. In this manner, a state has been created that enjoys budgetary decentralisation, especially in relation to expenditure, this being the main characteristic of the Spanish welfare state. Effect is given to this decentralisation by transferring the powers and services of the State Administration to the Autonomous Communities. The main consequence of this model is that the budgets of the Autonomous Communities are growing at a more rapid pace than that of the State, the budgets of the former having tripled over the last few years. As a result of this high degree of decentralisation, the model of the Spanish state can be considered to be similar to the federal structure of countries like Germany, Austria, Canada and Switzerland.

The largest of the four items that comprise the basic social expenditure of the State (Social Protection and Security, Health Care, Education and Housing) is Social Protection and Security (see Table 1). Health Care is the item of social expenditure that has the second highest priority in terms of social expenditure in quantitative terms. However, the expenditure on health care is far less than the expenditure on social protection and security, while health care expenditure also differs from the latter in the sense that the former enjoys a strong Autonomous component, which is in the process of being expanded as powers are being transferred to the Autonomous Communities. The expenditure on Education occupies the third place. Mention should also be made of the Autonomous component in expenditure on education, which is being expanded even further as services are being transferred to the Autonomous Communities.

It should be pointed out that the last item of basic social expenditure, namely Housing, is far smaller than the other items of expenditure (representing less than 1% of the total expenditure). The powers in relation to this budgetary item were transferred to the Autonomous Communities in 1984 already. In summary, during these years we have observed a constant growth in the social expenditure of the Autonomous Communities at the expense of the expenditure of the State Administration (see Table 2).

Changes in the Financing of Welfare: 1985 to 2000

When looking at social expenditure in quantitative terms, it can be said that the Spanish welfare system is essentially comprised of Social Security and Health. These two items accounted for two thirds of the total social expenditure during the year 2000.

Social Security

The financial structure of Social Security in Spain has been changing throughout the period in question (1985 to 2000), these changes having been brought about through legislative reform. Before 1985, the system was characterised by the fact that Social Security was financed through social security contributions as well as the state budget. Thus, there was no distinction in the financing of benefit payments, health care and social services.

The most important reform that took place during the period of 1985 to 2000 could be considered to have been the enactment of the so-called 'Pensions Act' (the Act on Urgent Measures for the Rationalisation of the Structure of the Protective Activities of Social Security, No 26/1985). In terms of the legislation in question, the contributory nature of the pensions system was reinforced, while establishing the importance of creating a closer correlation between pensions and contributions (the actuarial principle).

The Budget Act of 1989 brought about further reform in the finance system. This act made provision for the specific allocation of funds in terms of the State budget. Consequently, the budget for the year in question (1989) already determined the amount that would be allocated specifically to health care, while it also stipulated minimum pension benefits. The social security contributions were appropriated to the financing of contributory benefit payments. This undoubtedly constituted the first step towards creating separation between the various sources of finance.

The Act on Non-Contributory Pensions, No 26/1990 of 20 December, was passed in 1990 to make provision for people who do not have sufficient means, while the right to health care was also expanded to include such people. This new area of activity for Social Security is financed entirely through the State budget (general taxes).

Real Legislative Decree 1/1994 of 20 June, which was passed in 1994, enacted a new version of the General Social Security Act. This was also the year in which the system of budgeting according to programmes, as well as the Comprehensive Social Security Accounting System, were implemented.

In short, certain important reforms were carried out during the period of 1985 to 1995, as a result of which it become possible to conclude the so-called 'Pact of Toledo' in 1997. The recommendations that were set out in the Pact of Toledo lead to further reform in the Social Security system. The changes that were brought about can be summed up with the following points:

1. Reinforcing the contributory nature of the system, improving the correlation between benefits and contributions on the one hand, and between contributions and salaries, on the other;
2. Guaranteeing the buying power of pensions and improving the coverage of minimum pensions;

3. Simplifying and rationalising the various systems with regard to both contributions and benefits;
4. Creating definitive separation between the sources of finance. In this regard, it was established that the contributory benefits are financed by the social security contributions, while the non-contributory and universal benefits are financed in terms of the State budget (being financed through general taxation).

The Pact of Toledo lead to the passage by Parliament of the Act on the Consolidation and Rationalisation of the Social Security System, No 24/1997.

During the period of 1997 to 2000, an important process of clarification was set in motion in relation to the financing of Social Security. The process in question has been completed in respect of health care and social services, these now being financed wholly through taxation, although the process of separating the sources of financing was not completed fully during the required time.

As a result of the separation of the sources of financing for Social Security, budget surpluses have been achieved under the budgetary item in question since 1999. These surpluses were allocated to the creation of a Reserve Fund to cover any possible financing shortages in the future and also the strengthen the long-term viability of the pensions system. In 2001, the fund in question amounted to 90,000 million Pesetas, increasing to 1,051.77 million Euros in the year 2002 (Ministerio de Hacienda, 2002).

The separation of the sources of financing received legal treatment in Section 86 of the new version of the Social Security Act (Real Decree 1/1994, of 20 June), establishing the two current models, namely the contributory model and the welfare or universal model (see Tables 3, 4 and 5). The contributory model is financed basically through the contributions of workers. The universal model, on the other hand, has been separated from economic activity, being financed through the State budget (financing through general taxation).

As a result of the implementation of the recommendations of the Pact of Toledo, the social security contributions have been reduced from 76% to 64.4% during the period of 1985 and 2000. At the same time, the transfers from the State have increased from 21.3% to 31.4%. There has also been a slight increase under the heading of ‘other income’, having increased from 2.8% to 4.7% (see Table 6). Expressed as a percentage of GDP, the social security contributions remained steady between 9.5% and 9.7% during the period of 1985 to 2000. The contributions of the State have fluctuated between 2.7% and 4.8% (see Table 7).

It is important, furthermore, to mention the importance of the loans that have been granted by the State, in other words, the debt that has been allocated to Social Security. This can be classified into three types:

1. Loans granted to INSALUD (Instituto Nacional de la Salud, National Health Service) in 1992, 1993 and 1994;

2. The loans granted by the State to Social Security for the purposes of covering the budgetary deficit that was caused by an insufficiency in the financing of the non-contributory and universal benefits by the State itself, especially in relation to health care;

3. Loans granted to Social Security by the State for the purposes of covering the treasury imbalance that was caused by the differences in the accounting methods that are based on cash receipts and on accrual in relation to income from social security contributions.

By the year 2000, the changes that were made to the financing system had the result that the health care benefits of INSALUD, the social services of the Institute of Migrations and Social Services (IMSERSO – Instituto de Migraciones y Servicios Sociales) and the family protection services were financed through the State budget (general taxation). By way of example, it can be pointed out that the social security contributions accounted for 20.8% of the budget of INSALUD in the year 1995, while this percentage was reduced to 0% in the year 2000 (see Table 3).

Health Care

The changes that were made to the financing of Health Care during the period of 1985 to 2000 were brought about, to a large extent, as a result of the passage of the General Health Care Act, No 14/86 of 25 April, as well as the process of decentralising powers in relation to health care to the Autonomous Communities.

The National Health Care System was created in terms of General Health Care Act of 1986, the administrative and territorial organisation of the health services in Spain being set out in the Act in question. The main elements of the reform in question consist of universal health care and the public financing thereof through taxation. These measures came into effect in 1989 by virtue of the State Budget Act for the year in question. 79.2% of the budget of INSALUD was contributed by the State in the year 1995 (financing by way of taxation), while the State financed 100% of the said budget in the year 2000 (see Table 8).

The process of territorial decentralisation that was carried out since the Eighties had a crucial impact on the financing of health care in Spain. For these purposes, the State territory was divided into two blocks (although it is envisaged that all the Autonomous Communities will undertake the financing in question in future).

1. The Autonomous Communities which have not taken transfer of any powers in relation to health care; In this case INSALUD is administered directly by the State;
2. The Autonomous Communities to which the administration of INSALUD has been transferred.

By the year 2000, the powers in relation to health care had been transferred to seven Autonomous Communities, namely Catalonia (INSALUD was transferred in 1981), Andalusia (1984), the Basque Country and the Community of Valencia (1988), Navarre and Galicia (1990) and, lastly, the Canary Islands (1994). To gain an impression of the importance, in both quantitative and qualitative terms, of these transfers, mention must be made of the fact that the Autonomous Communities that are responsible for the administration of INSALUD accounted for 60% of the country's population in the year 2000, while these Autonomous Communities administered 62% of the total budget of INSALUD in the year in question.

As a result of the separation of the sources of financing for Social Security, the budget of INSALUD was completely separate from that of Social Security in 1999. The social security contributions, which financed more than 80% of the health care expenditure in the year 1985, have disappeared completely. At present, the State finances the health care budget entirely by way of taxation (see Table 3).

The financing of the health care services that were transferred to the Autonomous Communities takes place in accordance with the criterion that was laid down in Section 82 of the General Health Care Act, No 14 of 1986, namely the size of the protected population in each territory. Consequently, the funds that are allocated to the financing of health care are distributed in accordance with the number of inhabitants of each Autonomous community. Since the time of the first transfers of the social security health care services until 1994, the budget of INSALUD was distributed between the Autonomous Communities in accordance with the number of people that reside in each Autonomous community.

The financing for the period of 1994 to 1997 was established in terms of an accord that was concluded on 20 September 1994 by the Committee for Finance and Tax Policy. Additional resources were appropriated for the purposes of financing health care and a progress criterion was formulated for the resources in question in accordance with the nominal GDP of each year during the period for which the said accord would be in force, while the calculations relating to the protected population were also updated. Lastly, an additional fund was set up for the purposes of financing health care for people who find themselves outside the Autonomous community in which they reside.

In 1997, another accord was concluded to regulate the financing for the period of 1998 to 2001 (the Accord of 27 November 1997). The new accord retained the general criteria that were included in the Accord of 1994. Furthermore, a 'Fund for General Health Care' was set up, which is distributed among the Autonomous Communities in accordance with the size of each such community's resident population in 1996. This fund accounts for 96.5% of the total budget, while the remaining 3.4% is made up of other small funds, such as the Compensatory Fund for the Loss of Protected Population, the Compensatory Fund for the Expenses of Providing Health Care to People Away from their Place of Residence and the Fund for the Rationalisation of the Expenditure on Benefits for Temporary Disability.

Education and Housing

Education policy has a much smaller budget than the two main items of social expenditure (namely Social Security and Health Care) that exist within the context of the Spanish welfare state (see Tables 1 and 9). The main characteristic of the Education budget is the decentralisation thereof. Education is administered directly by the Autonomous Communities that have full powers in relation to Education, which include Andalusia, the Canary Islands, the Community of Valencia, Galicia, Navarre and the Basque Country, while the remaining Autonomous Communities, which have deferred powers in this regard, administer education jointly with the State (territory of the Ministry of Education and Science). The total Education budget is split almost equally between the two mentioned groups of Autonomous Communities.

Housing policy is a very small budget item in relation to the total budget (see Table 9).

The Decentralisation of Social Expenditure

The process of transferring powers to the Autonomous Communities accelerated enormously between 1980 and 1984. One year later, the social expenditure of the Autonomous

Communities accounted for a little more than 16 percent of the total budget for social expenditure. The expenditure of the Autonomous Communities grew at an ever-increasing pace with the transfer of more important budgetary items, such as Health Care and Education, with the result that the expenditure in question grew at a much higher rate than the expenditure of the State. In 1992, the decentralised social expenditure amounted to 27 percent, increasing to 31 percent in the year 2000 (see Table 2).

Social expenditure accounts for more than half of the total expenditure of the Autonomous Communities (see Table 10). Within this general observation, it is possible to distinguish between two groups of Autonomous Communities: firstly, those Autonomous Communities that have undertaken powers in relation to Health Care and Education, in which social expenditure accounts for approximately 45% of the total budget; and, secondly, those Autonomous Communities which have still not taken transfer of the services in question, in which social expenditure accounts for 24% of the total budget.

Figure 1 shows the upward trend of the social expenditure of the Autonomous Communities in relation to Health Care and Social Services. These two budget items account for the largest part of the social expenditure of the Autonomous Communities.

Health Care

The budgets of the Autonomous Communities that have taken transfer of administrative powers in relation to health care differ greatly from those that have still not taken transfer of the powers in question. When health care services have been transferred to all the Autonomous Communities, the budget for decentralised health care will be much higher than that of the Central Administration's health care budget.

Social Services

In terms of Section 149 of the Spanish Cosntitution, the Autonomous Communities are empowered to undertake full powers in relation to social services and assistance. So each one of the Autonomous Communities has exercised the aforesaid powers to enact legislation in respect of their social services, which legislation contains a section that deals specifically with the financing of social services and assistance. Furthermore, the Autonomous Communities have the obligation to make provision in their respective annual budgets for the appropriation of the resources that are necessary for the establishment and maintenance of the said services. In short, the social services in Spain are essentially financed by the territorial administrations (the Autonomous Communities and local authorities).

In 1988, the Official Plan for the Basic Social Services of the Local Authorities was drawn up with the aim of establishing a public system of social services that provides universal primary health care. In this regard, the information contained in Table 11 reflects a clear reduction in the financing that is provided by the State, while the financial contributions of the territorial administrations have increased.

Future Trends and Prospects

The Accord that was concluded by the Committee of Finance and Tax Policy on 27 July 2001, which deals with the General Finance System of the Autonomous Communities, will have a significant impact on the financing of the health care and social services as from the year 2002. This accord represents a further step in the decentralisation of the Central

Administration's budget in favour of the Autonomous Communities. The resources that have been transferred by the Central Administration for the purposes of financing the administration of the social and health care services which have been undertaken by the Autonomous Communities, are going to be grouped together in a single block, together with the resources that are used to finance the general powers.

In view of the fact that the State is still exclusively responsible for Social Security's financial system, the principle of appropriations for specific purposes has been introduced, which provides that those Autonomous Communities which have undertaken the administration of the social and health care services are obliged to allocate a predetermined quantity of resources to the administration of the services in question. The consequence of this, in budgetary terms, is that the State will cease to make transfers for the purposes the social and health care services, which transfers will essentially be replaced by the cession of taxes to the Autonomous Communities.

The new system of finance differs as follows from the finance system that existed before. A distinction is drawn between three large blocks of expenditure that need to be financed, namely general powers, social security health care expenditure and the social services that are provided by Social Security (IMSERSO). The point of departure of the new system is the calculations for the year 1999 (the so-called initial restriction). Once the initial restriction has been established, an assessment is made of the financial needs of each Autonomous community, which assessment is made on the basis of a series of variables.

Blocks of expenditure to be financed:

a) General powers: three instruments are envisaged for the purposes of providing for the financial needs of this first block of powers, these being as follows:
   1. The General Fund, which is distributed in accordance with population, surface area, dispersion and isolation;
   2. The Relative Income Fund, which is awarded to those Autonomous Communities whose relative population is higher than their relative Gross Added Value. There are ten Autonomous Communities that receive finances from the fund in question, namely Andalusia, Asturias, the Canary Islands, Cantabria, Castile-Leon, Castile-La Mancha, Extremadura, Galicia, Murcia and the Community of Valencia;
   3. The Low Population Fund: Aragon and Extremadura receive finances from this fund because their respective population densities are disproportionately low in relation to the size of their territories.

   If any Autonomous community should be unable to cover their general expenditure after the distribution of these funds, a supplement will be granted in accordance with the so-called Minimum Guarantee. Consequently, no Autonomous community will receive less funds than they did in 1999 for the purposes of financing their general powers, while some Autonomous Communities will receive more. Furthermore, a series of adjustments of the relevant growth rate is envisaged.

b) Health care expenditure: These funds are distributed in accordance with the size of the protected population, the number of inhabitants over the age of 65 years and the degree of isolation of the Autonomous community in question. Similarly, a minimum is established for the community's expenditure needs. In addition, the State guarantees that the resources which have been ceded to the Autonomous Communities for the purposes of financing health care will grow by at least the same rate as the nominal GDP growth rate, which

guarantee will be in force for the first three years during which the said system of cessions is in force.

c) Social Services (powers relating to IMSERSO): The financial requirements of this service is calculated in accordance with the number of inhabitants over the age of 65 years.

In summary, it is necessary for new transfers of powers in relation to expenditure (Health Care, Education and Social Services) to receive less financing in terms of the transfers that are received from other administrations. The expenditure in question needs to be financed to a greater degree through own resources and the collection of ceded taxes, in accordance with the latest reform that has been approved. One must also not lose sight of the fact that the powers which are now being undertaken by the Autonomous Communities will involve, for obvious reasons, an enormous increase in expenditure over the next few years. As a result of the ageing of the population, expenditure on health care will show one of the highest growth rates over a short period of time. However, it is also necessary to add the projected increase in expenditure on social services, which is due to the inevitable process of immigration. The expenditure that relates to the educational powers that have been transferred will, perhaps, remain constant, while it may even decrease slightly due to the population pyramid-effect. Consequently, the future of the Spanish welfare state will depend to a great degree on the capacity of the Autonomous Communities to finance their own social expenditure during the following years.

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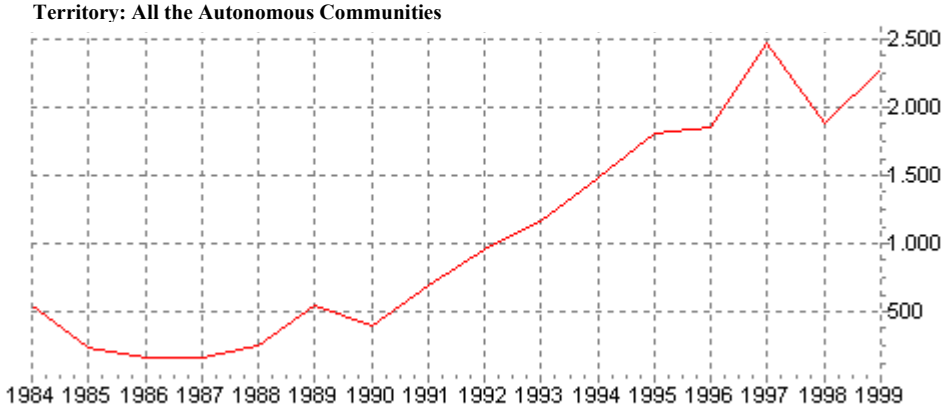
Figure 6.1: Budget of the Autonomous Communities.

BUDGET OF THE AUTONOMOUS COMMUNITIES. THE ADMINISTRATIVE BODIES OF SOCIAL SECURITY. EXPENDITURE. FINANCIAL ASSETS (CHAPTER 8). ADMITTED LIABILITIES.

Institution/Organism: Autonomous Communities
Territory: All the Autonomous Communities



Unidad: Millones de pesetas
Fuente: Dirección General de Coordinación de las Haciendas Territoriales

[Translation of text at foot of Graph:
"Unit: Millions of Pesetas
Source: Directorate-general for the Coordination of the Territorial Revenue Services]

Table 6.1: Breakdown of social expenditure. (Central Administration and the Autonomous Communities)

Policies	Budget as a percentage of the total of expense policies			
	1985	1992	1995	2000
Pensions	16.91	23.1	23.6	27.60
Social Benefits	6.50	5.0	4.9	3.30
Unemployment	5.73	6.5	6.8	4.00
Health Care	9.01	10.8	11.2	13.20
Education	8.00	5.5	3.7	2.20
Housing	0.59	0.4	0.4	0.33
Other	1.10	1.0	1.2	4.47
Total Social Expenditure	47.80	52.3	51.8	55.10

Source: Ministerio de Hacienda (several years).

Table 6.2: Territorial distribution of public expenditure in Spain (%)

	1981[1]	1984	1987	1990	1992	1997	2000[2]
Central	87.3	75.6	72.6	66.2	63.0	59.5	54
Regional	3.0	12.2	14.6	20.5	23.2	26.9	33
Local	9.7	12.1	12.8	13.3	13.8	13.6	13

[1] Beginning of the process of devolution
[2] Government's estimates

Source: MAP (1997).

Table 6.3: Benefits and Incomes of the Social Security System

Benefits covered by the Social Security System	
Contributory benefits	Non-contributory and universal benefits
-Contributory pensions: retirement, permanent disability, death and death of a breadwinner; -Temporary disability; -Maternity; -The administrative expenses of these benefits.	-Minimum pension benefits; -Non-contributory pensions; -Health care; -Social Services; and -Family benefits.
Income available to the Social Security System	
Contributory origin	Universal origin
-Contributions for general contingencies and occupational accidents; -Other own income.	-Transfers from the State (source: general income)

Table 6.4: Consolidated expenditure on Social Security: % of GDP

Year	Benefit payments			Health care	Social services	Total
	Total	Contributory pensions	Rest			
1985	8.7	7.5	1.2	3.8	0.2	12.6
1990	8.5	7.5	1.0	4.3	0.4	13.2
1995	9.8	8.5	1.3	4.7	0.3	14.9
1996	10.0	8.7	1.3	4.7	0.3	15.1
1997	9.9	8.7	1.2	4.5	0.3	14.8
1998	9.8	8.6	1.2	4.6	0.3	14.7
1999	9.6	8.4	1.5	4.5	0.3	14.4
2000	9.8	8.6	1.2	4.6	0.3	14.6

Table 6.5: Consolidated expenditure on Social Security: % of the total

Year	Benefit payments			Health care	Social services
	Total	Contributory pensions	Rest		
1985	68.2	59.0	9.2	29.5	1.4
1990	63.3	56.1	7.2	31.6	2.9
1995	65.2	56.4	8.8	31.1	2.3
1996	65.7	56.9	8.8	30.8	2.0
1997	66.3	57.7	8.6	30.2	1.9
1998	65.5	57.4	8.1	31.0	2.0
1999	65.7	57.5	8.2	30.6	2.0
2000	66.0	58.2	7.8	30.8	1.8

Table 6.6: Social Security System: Income as a percentage of the total

Year	Contributions	Contributions by the State	Other
1985	75.9	21.3	2.8
1990	71.8	25.7	2.6
1991	71.2	26.2	2.6
1992	71.9	26.1	2.0
1993	70.9	26.7	2.3
1994	65.9	30.4	3.7
1995	64.0	33.8	2.2
1996	63.7	33.4	2.9
1997	65.6	31.4	3.0
1998	65.2	31.6	3.1
1999	64.4	31.0	4.6
2000	63.9	31.4	4.7

Table 6.7: Social Security system: income as a % of GDP

Year	Contributions	Contributions by the State	Other	Total
1985	9.5	2.7	0.4	12.5
1990	9.7	3.5	0.3	13.5
1991	9.9	3.6	0.4	13.9
1992	10.4	3.8	0.3	14.5
1993	10.7	4.0	0.4	15.1
1994	11.0	5.1	0.6	16.7
1995	9.6	5.1	0.3	15.0
1996	9.7	5.1	0.4	15.3
1997	9.8	4.7	0.4	14.9
1998	9.8	4.8	0.5	15.1
1999	9.8	4.7	0.7	15.3
2000	9.7	4.8	0.6	15.1

Table 6.8: Public Expenditure on Health care 1985-2000 (Consolidated budget: Central Administration and Autonomous Communities)

Year	% Ependiture (1)	% of Financing	
		Contribution by the State (taxation)	Social Security Contributions
1985	9.01	16.2	83.8
1992	10.80	72.8	27.2
1995	11.20	79.2	20.8
1998	12.80	95.2	4.8
2000	13.20	100	0

(1) The health care budget as a percentage of the total budget.

Source: Ministerio de Hacienda (several years).

Table 6.9: Public Expenditure on Education and Housing 1985-2000 (Consolidated Budget)

	1985	1992	1995	1998	2000
Education	8.00	5.5	3.7	3.4	2.2
Housing	0.59	0.4	0.4	0.4	0.3

Source: Source: Ministerio de Hacienda (several years).

Table 6.10: Autonomous social expenditure. Year 2000

Items of Expenditure	Budget (%)
Social Security, Protection and Upliftment - Social Security and Protection (4.48) - Social Upliftment (2.58)	7.06
Health Care	24.07
Education	24.34
Housing and Development	2.25
Others	4.13
Total Social Expenditure	61.85

Source: Dirección General de Coordinación con las Haciendas territoriales, Ministerio de Hacienda (several years).

Table 6.11: The Contributions of the Various Administrations to the Plan Accord (1988 to 1997), as a percentage.

Year	Local Authorities	Autonomous Communities	Ministry of Labour and Social Affairs	Total
1988	41.5	32.8	25.7	100
1991	41.1	33.0	26.2	100
1993	50.5	28.2	21.3	100
1995	51.1	28.5	20.4	100
1997	56.0	25.0	17.0	100

Source: Fundación Encuentro, CECS (2001).