

Greece

The nemesis of a monolithic unreformed pension system

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Five features of the pension problem

1. The system is **Costly**,
 - ▶ **Currently pensions absorb >12% of GDP.**
 - ▶ **Second highest in EU-27**
2. ... and faces **dramatic demographic challenges**.
 - ▶ **Dependency ratio → 2nd fastest deterioration in EU**
3. It is also **economically inefficient**,
 - ▶ Patchwork of cross-subsidisation, non-wage costs. Costs borne disproportionately by private sector, exports.
4. **...socially ineffective ...**
 - ▶ Poverty is **'grey in colour'**. Concentrated on 65+.
 - ▶ Once one steps into 'the bosom of the Welfare State' poverty **increases**.
5. ... and **resistant to change**.
 - ▶ 'Reform by instalments' since 1990. (or even earlier).
 - ▶ Last instalment March 2008. Already Bank of Greece is asking for more.
 - ▶ System architecture essentially unchanged for 75 years (since 1934).

Inability to implement simple solutions

- ▶ A feasible strategy for a long term solution is **easy to define**. 2 steps would suffice:
 - I. Activate '**Labour reserves**'.
 - ▶ Increase labour participation of mothers and of older workers.
 - II. **Rationalisation** towards greater uniformity
 - ▶ limit public generosity to the better off +increase social effectiveness.
- ▶ Combines **economic efficiency** and **social justice**.
 - ▶ Should have been a win-win strategy.
- ▶ Yet, difficult to implement.
 - ▶ Reform outline essentially unchanged since mid-1950s.
- ▶ **WHY?**
 - ▶ Paradox of combining **Monolithic system** + **Fragmentation**

The Fragmented Monolith

- ▶ The system is *exceptionally* fragmented:
 - ▶ By **sector of employment**,
 - ▶ Major fault lines: private employees, public employees, professions, self-employed, farmers
 - Many divisions within major occupational groups
 - ▶ By **pension tranche**
 - ▶ Primary, supplementary pensions and separation payments
 - ▶ by **pension provider**
 - ▶ independent PAYG funds, governed by own governing boards
 - ▶ By **cohort**
 - ▶ Pre and post 1983, pre and post 1993, now pre and post 2008
- ▶ **YET** it remains **Monolithic**.
 - ▶ **All** parts of the system **PAYG**. Under State guarantee.
 - ▶ Mandated by Law. Must be changed by Parliament.

Explaining the Monolith: 75 years of history

- ▶ **Key Social insurance law passed in 1934 as a **compromise**.**
 - ▶ Rather than replacing old sectoral pension providers,
 - ▶ It set up main private sector social insurance institution (IKA) as a pole of attraction
 - ▶ Designed to gradually absorb 'old' arrangements to arrive at a unitary State system.
- ▶ **1934 project *still* under implementation in 2009.**
 - ▶ Centrifugal forces set in – secure **sectoral** privileges *within* State system.
 - ▶ Cross-subsidisations under the umbrella of a State guarantee.
 - ▶ Attempts to start **2nd pillar occupational systems** ineffectual.
 - ▶ Legal framework set up in 2003. little interest (<3% of expenditure)
 - ▶ 2 obstacles:
 - i. Crowded out by 1st pillar (high replacement rates for the better off).
 - ii. Uncertainty and lack of clarity vis-à-vis relations with 1st pillar.
 - “planning blight” of being unsure how 2nd and 1st pillar fit together.

Fragmentation and the political economy of pension reform

- ▶ Fragmentation + lack of transparency → '**Social Insurance Kaleidoscope**'
 - ▶ Difficulties to define the problem and agree on a solution.
- ▶ Pension reform appears in 3 guises:
 - 1) As **Redistribution *between* generations** → **Actuarial** issue.
 - ▶ Alter actuarial balance. Look at the v. long term. Link to Debt.
 - 2) As **Redistribution *within* generations.** → **Public finance** issue
 - ▶ 'who pays?'. Medium-term perspective. Link to Deficit.
 - 3) As **Distribution of political influence** → **Governance** issue
 - ▶ Fragmented laws need interpretation on day-to-day basis. Short-term.
- ▶ Last attempt (Law 3655/08) clearly oriented towards (3). **Why?**
 - ▶ **2006 scandal** of exorbitant fees for Structured Investment Vehicles (SIVs) bought by State Pension Funds.
 - Had the effect of "Immunising" Greece from toxic assets early on.
 - Brought the issue of **fragmentation of control** to the forefront.
 - Governance issues (Minister of Economy: "Clueless Management Teams" in Funds)
 - ▶ As a result aspects 2 and 3 **are essentially untouched**
 - ▶ Last major intervention in 1992 (Law 2084/92)
 - ▶ 2002 tried to alter medium term dynamics (Law 3029/02).

State of the pension system on the eve of the economic crisis

- ▶ The crisis finds the pension system **without a road map for the future.**
- ▶ **Long term issues:**
 - ▶ Rationalisation + consolidation project **still** to be implemented
 - ▶ 1934 design still to be completed.
 - ▶ Ageing begins in earnest around 2015.
 - ▶ Greek baby boom started late. 1980s fertility drop begins to bite.
 - ▶ Greece needs to face 20th century issues simultaneously with 21st.
- ▶ **Medium term issues:**
 - ▶ Around 30% of expenditure financed by Government grants.
 - ▶ Pensions (and health care) major determinants of Gov't deficits.
- ▶ **Governance issues**
 - ▶ Lack of transparency.
 - ▶ 2008 consolidates decision structures and retains remaining fragmentation
 - ▶ Inefficient collection mechanisms. Widespread avoidance – evasion.
 - ▶ Lack of ability to distinguish real needs.
 - ▶ No functioning Unique Social Security Number and inability to handle personal information

The character of the current economic crisis in Greece

- ▶ Greece *so far* is immune from *impact* effects of crisis
 - ▶ Financial sector has little exposure to toxic assets
 - 'Immunised' by 2006 SIV scandal??
 - ▶ Real estate prices have *not* been affected.
 - ▶ Large infrastructure projects financed by EU-aid proceed.
- ▶ It *may be* vulnerable from second-round effects:
 - ▶ Effect on tourist revenue in the 2009 season.
 - ▶ Fall in shipping profits.
 - ▶ Effect on confidence
 - ▶ Exposure to SE European markets may be a danger in 2009.
- ▶ **BUT.** Weak macro position *predates* crisis. (despite high growth)
 - ▶ Size of National Debt \approx 100% of GDP
 - ▶ Deficit already above 3% SGP limit.
 - ▶ Balance of payments problems and competitiveness
 - ▶ Very few structural reforms implemented.
 - ▶ Labour market very protected (insider/outsider model).

Pensions and the crisis

- ▶ The 1st pillar pension system is directly affected by the crisis:
- ▶ **EXPENDITURE.**
 - ▶ 1st pillar pensions appear as 'safe haven' from the labour market.
 - ▶ Acceleration of pension application for those who can.
 - ▶ Other social protection expenditure grows (e.g. Unemployment)
 - ▶ Social protection expenditure serves as political 'pressure valve'
 - ▶ Counter-cyclical increases in benefits per head
- ▶ **REVENUE.**
 - ▶ In a liquidity shortage, delaying or avoiding payment of contributions appears as a cheap and ready source of capital.
 - ▶ Contribution evasion increases.
- ▶ **Social effects** of crisis and 'horizontal' inequalities worsen
 - ▶ LIFO operation of labour market reinforces social problems
 - ▶ women, immigrants and precarious employment suffer most.
- ▶ Spread of 2nd pillar pensions likely to be impeded.

Prospects for pensions in the crisis

- ▶ Existing problems will be **magnified** and **accentuated**.
 - ▶ Deficits, need for Gov't grants all grow.
 - ▶ Effects on *competitiveness* will be felt more strongly.

THUS:

- ▶ The **Visibility** of pensions as a **component** and a **cause** of the **overall public finance problem** of the Greek State will be enhanced.
 - ▶ Historically:
 - ▶ The fragmented pension system has no budget constraint of its own.
 - ▶ that role was played by the overall public finance constraint. (1990/2 and the threat of cash shortage)
- ▶ **Already** the financing and dynamics of National Debt appear as the most pressing issues of the crisis.
 - ▶ If so, the contribution of pensions to that will be brought centre stage.
 - ▶ The pressure for pension reform will mount up
 - ▶ That pressure will be external. (Strongest from EU, ECB, outside pension funds.
- ▶ **But**, will the pressure lead to meaningful reform?
 - ▶ Or simply add another instalment to the long list of failed attempts?