# Reforming the Greek pension system: A new social contract

## Introduction

The Greek social security system is an established institution with a multifaceted role in the context of a family centered social culture and not just a mere mechanism of transferring money to the elder ones. It secures the continuity among the generations not only in place but also in time by mitigating the negative effects of the economic cycle. In this respect, many years of recession eroded the very basis that supported this system. Several attempts by the previous administrations to ensure the viability of the pension system focused on horizontal spending cuts that deepened the downward spiral of recession, unemployment and the consequent need for new cuts in social benefits. This resulted in 11 totally ineffective interventions on our pension system leaving it in the brink of collapse.

We took the initiative to reform the Greek social security system not by introducing small incremental changes but instead, we propose a whole new coherent system to challenge the vicious circle described above and protect the most in need with a vision to create a viable and fair social security system for the generations to come.

In this brief report, we present a short historical background of the Greek pension system, the macroeconomic factors that made the reform inevitable, a sketch describing the philosophy and its main characteristics of our reform proposal and the most recent developments in this process.

## Short historical background

According to the data, the total pension spending of the Greek pension system was almost equal to the EU average spending until 2008. After the crisis the gap between Greece/EU has been increased dramatically. The unsuccessful structure of the previous memoranda (i.e. the fiscal multiplier effect of the measures) had negative impacts on growth rates (25% decline of the GDP), unemployment rate (26% from 7% on 2008) and pension spending/GDP (17,5% from 12,5%). The previous governments in cooperation with the institutions tried to reduced the pension spending by horizontal cuts on pensions. It has been calculated that the pensions decreased on average by 30% but they did not have the desired results. Instead they caused social problems by increasing the (risk of) poverty ratio. Also the cuts applied in the period 2010-2012 challenged the legitimacy of the system because of the huge number of employees who were forced to retire (300.000 cases currently pending).

From the other hand, we have to admit that the Greek public pension system was an unsuccessful example of overregulation and unequal treatment of citizens. Main characteristics of the system were favotirism and clientelism that throughout the years created huge differences in the rules regarding contributions schemes and pensions, even between similar professional groups. For example, in 1997 there were 28 operating main insurance agencies assisted by over 200 subsidiary insurance entities. Currently, pensions are provided by 21 organizations. As the associated pension system costs became unbound from pension system inflows, the difference was financed through state support. Fiscal impact became the predominant pressure for changes.

## Macroeconomic factors and the need for reform

Despite the distortions and the designing flaws of the Greek pension system described above the decisive blow was caused by the severe recession and the huge unemployment that entailed. During the period 2010 - 2014, there was a 19.2% reduction of the insured due to the rapid rise in unemployment. Directly affiliated to Social Security decreased from 2.5 mil. in 2009 to less than 2 mil. in 2014. The ratio of pensioners to insured in IKA fell at 1: 1.7 while we need at least 1:2.1. The common accusation that our pension system is more generous compared to our partners is solely based on the ratio pensions spending/GDP and for this reason is quite misleading. Actually, the 24% of pensioners receives less than 500 Euros and the 65,8% less than 1000 Euros, while only the 1,89% gets more than 2000 Euros.

A more holistic consideration of the latest data from Ageing report 2015 and OECD's pensions at Glance 2015 reveals a different picture. Greece was very close with the EU average in this respect before the crisis and stands behind the EU average as far as the employers' social contributions are concerned. Demographic trends are also very illustrative. We have the same life expectancy as our partners but with lower fertility rates. Unemployment projections are negative for many years ahead. It is surprising though, that productivity of labor is quite low in relation with other European economies while the percentage of beneficiaries under 65+ and early exits are quite under the European average and in some cases is less than those of Eastern countries. Therefore hadn't be the crisis, the Greek pension system would not be an outlier with respect to the EU experience. Its viability is mostly threatened by the long standing recession, the structural barriers and the idiosyncratic aspects of the Greek economy and not by its alleged generosity. Salaries of the insured in the private sector suffered a mean reduction of 21.8% in the last five years while 46% of new contracts involving a partial or job rotation, with similar proportional reductions in contributions paid. Social security system losses due to contribution evasion are estimated to 6-8.5 billion annually.

The imposition of internal devaluation programmes slashed unit labor costs faster than product prices, allowing for greater profit margins. The fact that exports didn't revive despite the huge adjustment, even though our trading partners' demand surprisingly increased the same period(proxy for export performance), proves that unit labor cost was not the main obstacle. The dogmatic economic view that a small increase in employers' contributions would hamper the competitiveness of the Greek economy is unjustified and ideologically biased.

**The new system: philosophy and main characteristics**

The mandate for reform of the country's social security system sets the challenging goal to introduce for the first time uniformity in rules, contributions and benefits developing a framework for equal treatment and fair enjoyment of the rights by all system beneficiaries. We Introduce:

a. **A single insurance operator for everyone**
b. **Uniform rules for calculating insurance contributions and pension compensation (exemptions provided only for special cases)**.
c. **National pension for everyone who has at least 15 years of insurance at the age of 67 or 40 years at the age of 62.** National pension is set at 60% of average income which is equal to the relative poverty threshold (amounting to € 384), and is fully financed by the State budget taking into consideration the GDP growth rate.

There will be no reduction in primary pensions. Furthermore, a recalculation of all pension compensations currently given shall take place, while there will be a personal replacement rate that will cover the difference between the current and the recalculated pension.

Under the new status, the total compensation shall be equal to the national pension plus the amount of the primary pension, which shall be calculated based on staggered replacement rates for the whole insurance lifetime. To this point, the pension reform ensures the public, universal and redistributive nature of social security system.

Pension contributions are set to the 20% of actual income. Thus, there will be no significant changes for employees. On the contrary, self-employed shall be affected as their contribution will be calculated on the amount of their actual income. In addition, farmer's contributions and pension benefits shall be equalized with those of the rest insured, leading this way to their complete integration into the social security system. The reforms concerning employees and self-employed shall be put in place by January 1st, 2017.

## Corrective steps along the way

Following an agreement ratified by the Law 4336/2015, Greek government pledged to save total resources amounting to 0.25% of GDP for the year 2015 and to 1% for 2016.

A series of interventions contributing to the achievement of the budgetary targets has been adopted, while the state Budget of 2016 incorporates the assessments of the effects by a new pension reform. More specifically:

Interventions legislated by the Law 4336/2015

There have been interventions aiming at the gradual increase of the retirement age as well as creating strong disincentives for early retirement. For the year 2016, savings through these measures are estimated at 46 mil. Euros for pensions and at 78 mil. Euros for one-off lump sums savings for future years are significantly increased.

Furthermore, there has been an increase of health contributions by 2% (from 4% to 6%) for primary pensions, while a retention of 6% has been imposed to the supplementary ones. The adjustment resulted in savings of 355 mil. Euros for 2015, while for the year 2016 is estimated to save revenue of 711 mil. Euros.

Moreover, by September 1st 2015, all supplementary pension funds have been put under the umbrella of a single supplementary pension fund (ETEA). In addition, by the 1st of January 2015, every supplementary pension fund shall be financed exclusively by its very own contributions.

Interventions planned for 2016

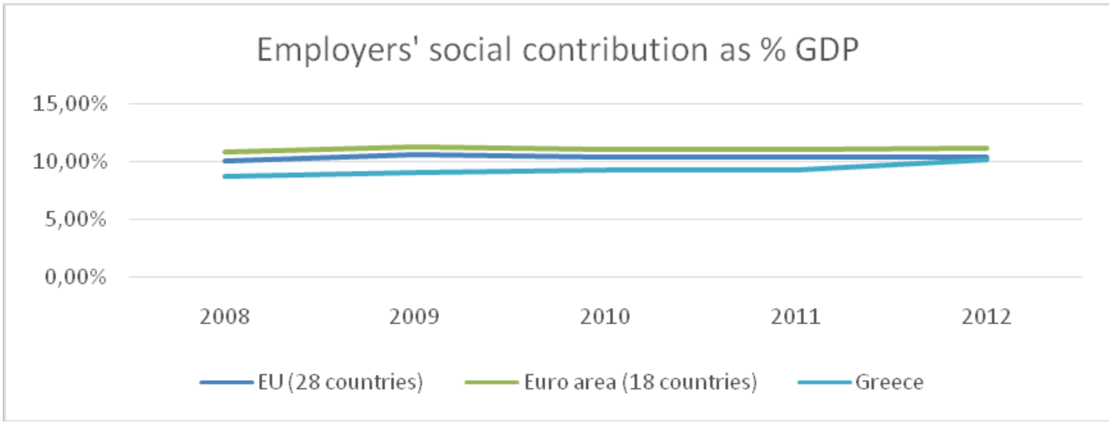
Towards the direction of achieving the 2016 savings target the Greek Government promotes a pension reform including, among others:

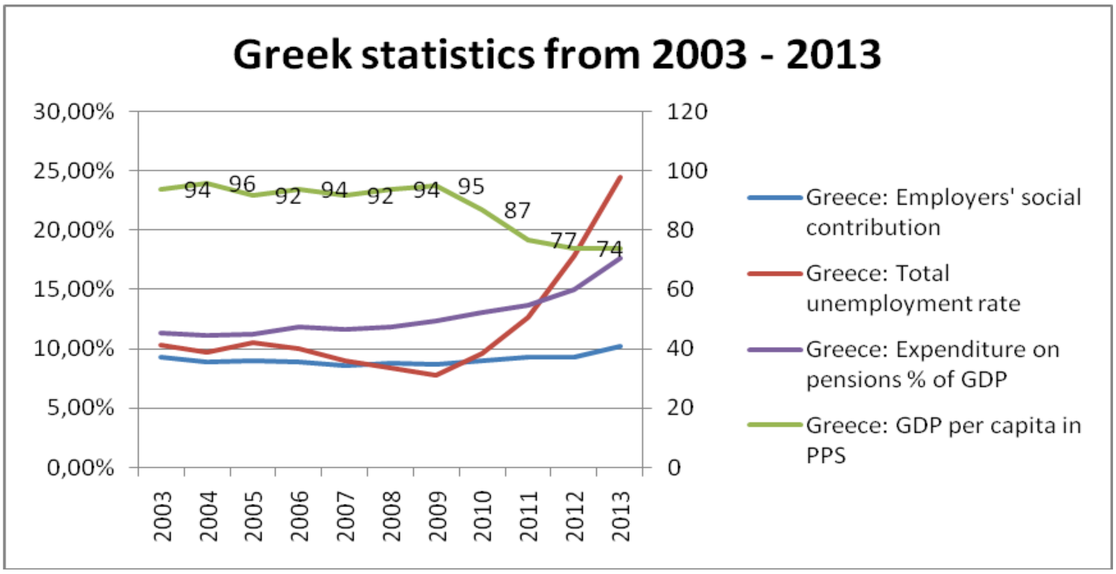
- An increase in contributions for supplementary insurance by 1 percentage point (0.5 for the employer and 0.5 for the insured). The impact of pension cost savings amounts to 300 mil. Euros.
- The consolidation of pension funds.
- A series of measures reducing one-off lump sums in early retirement cases (77.9 mn. Euros).
- The reduction of 20% of the beneficiaries of EKAS through the revaluation of annual income criteria (223 m. Euros)
- The gradual increase in contributions towards the Agricultural Insurance Organisation (102 m. Euros)
- The harmonization of the pension contribution rate with those of IKA (-25.8 mn. EUR)
- The provision of social solidarity benefit to uninsured elderly (-62 mil. Euros).

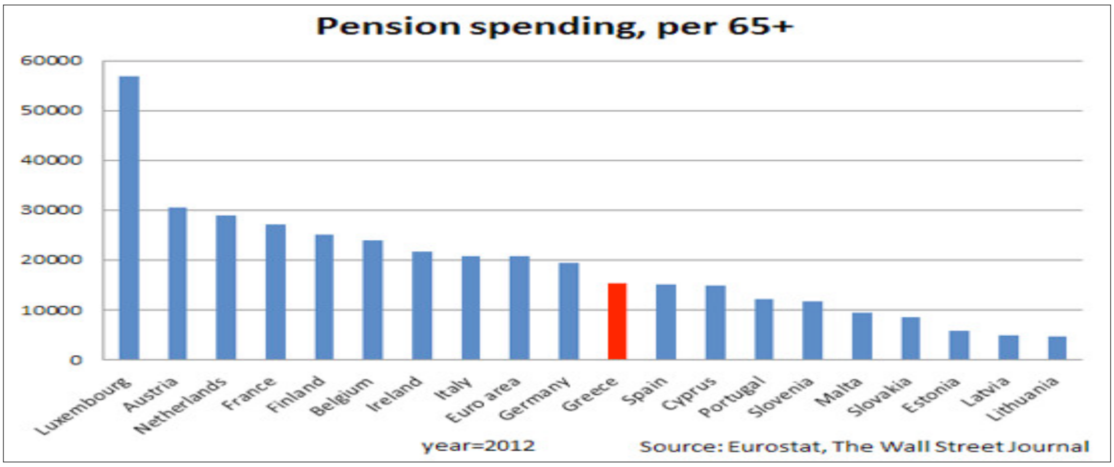
## Conclusion

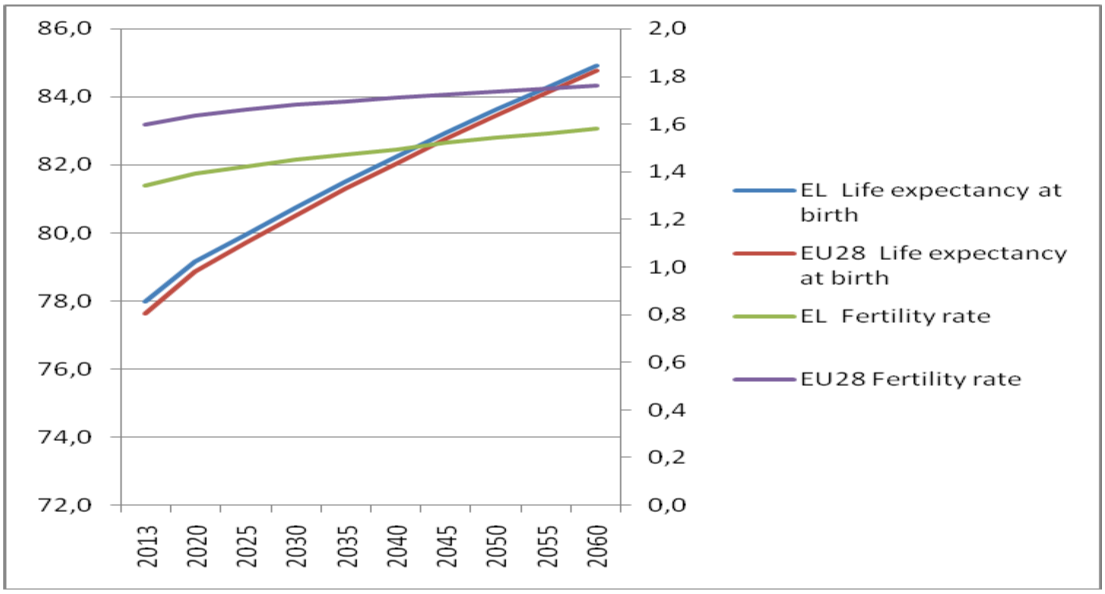
We tried in this short note to defend our proposal for a new social security system that fosters social solidarity and justice. We recognize the inherent flaws that the old establishment magnified and handed over us but we also stressed the deeper roots of the problem away from simplistic stereotypes. Our proposal is the outcome of an intrusive understanding of the complexities and the interconnections that a fundamental reform needs to take into account. We embrace the historical need for reform of our pension system but even the best possible system designed will collapse in a matter of years if introduced on a shrinking economy, as it happens to be Greece the last 7 years.

Annex


Employers' social contribution as % GDP
15,00%
10,00%
5,00%
0,00%
2008
2009
2010
2011
2012
EU (28 countries)
Euro area (18 countries)
Greece


Greek statistics from 2003 - 2013
30,00%
25,00%
20,00%
15,00%
10,00%
5,00%
0,00%
120
100
80
60
40
20
0
94
96
92
94
92
94
95
87
77
74
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Greece: Employers' social contribution
Greece: Total unemployment rate
Greece: Expenditure on pensions % of GDP
Greece: GDP per capita in PPS


Pension spending, per 65+
60000
50000
40000
30000
20000
10000
0
Luxembourg
Austria
Netherlands
France
Finland
Belgium
Ireland
Italy
Euro area
Germany
Greece
Spain
Cyprus
Portugal
Slovenia
Malta
Slovakia
Estonia
Latvia
Lithuania
year=2012
Source: Eurostat, The Wall Street Journal




**Income distribution (Greece)**

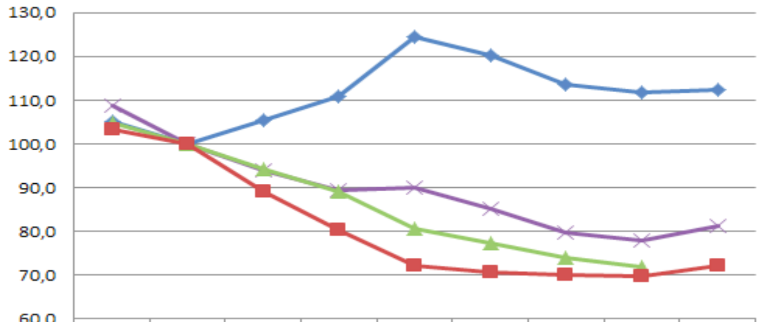
**2010 = 100**

Compensation of employees includes wages and salaries as well as employers' social contributions

Performance = relative to 36 industrial countries (EU-27, TR, CH, NR, US, CA, JP, AU, MX, NZ)

2015 - 2017: forecast

Source: AMECO, European Commission, 5 Nov. 2015




| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| Ratio gross operating surplus (adj. for self-empl.) to compensation of employees | 105,2 | 100,0 | 105,6 | 111,1 | 124,6 | 120,5 | 113,8 | 111,8 | 112,6 |
| Gross operating surplus (adj. for self-empl.) | 108,7 | 100,0 | 94,2 | 89,4 | 90,0 | 85,3 | 79,8 | 78,0 | 81,3 |
| Nominal compensation per employee performance | 105,1 | 100,0 | 94,4 | 89,1 | 80,9 | 77,4 | 74,0 | 72,0 | |
| Compensation of employees | 103,3 | 100,0 | 89,2 | 80,5 | 72,2 | 70,8 | 70,2 | 69,8 | 72,2 |

**Labour costs, export prices and market performance of exports (Greece)**

**2010 = 100**

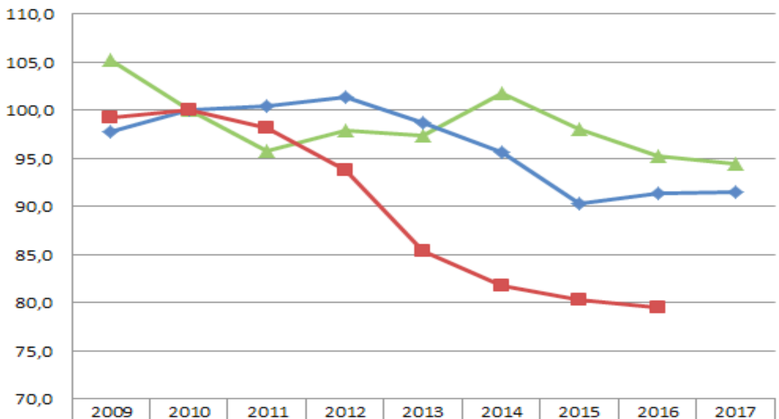
Unit labour costs include wages and salaries as well as employers' social contributions

Exports = goods and services

Performance = relative to 36 industrial countries (EU-27, TR, CH, NR, US, CA, JP, AU, MX, NZ)

2015 - 2017: forecast

Source: AMECO, European Commission, 5 Nov. 2015




| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| Market performance of exports | 105,3 | 100,0 | 95,7 | 97,9 | 97,4 | 101,8 | 98,0 | 95,2 | 94,5 |
| Price deflator exports performance | 97,8 | 100,0 | 100,4 | 101,4 | 98,7 | 95,6 | 90,3 | 91,4 | 91,5 |
| Nominal unit labour costs performance | 99,2 | 100,0 | 98,1 | 93,7 | 85,3 | 81,7 | 80,2 | 79,4 | |