The Greek Pension Reform Strategy 2010-2013

Steering away from the tip or the iceberg?

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Note: The Reform of the Greek Social Security Pension System is an ongoing process. This paper is written in November 2013 on the occasion of the ***World Pension Summit.*** *However, since then more reforms are being scheduled so if someone holds interest beyond the scope of the presentation made at the* **6th Global Pension and Savings Conference held by the World Bank** *or if they need more information, please contact the writer at the email addresses provided at the bottom of the paper.*

Introduction

In 2008, the Hellenic Actuarial Authority (HAA) provided the Economic Policy Committee subgroup, the Ageing Working Group (AWG), with projections for the public pension expenditure for years 2007 through 2060.

Under these projections, a staggering 24% of GDP would have to be set aside for public pension expenditure in 2060.

In 2010, Greece, under the pressure of an increasing public debt, was forced to resort to the tripartite committee referred to as the Troika, comprised of the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF).

The Troika agreed to provide Greece with financial help, on special terms recorded in a Memorandum of Understanding (MoU) between the Greek Government and the Troika.

One of the most important reforms that are recorded in the MoU is of course the Pension Reform since the Greek Social Security System had long showed signs of unsustainability and insolvency.

Then, in 2012, the Greek Government and the Troika, after assessing the fiscal impact of the reforms already implemented, and those which weren't, reached the conclusion that a new interim plan had to be devised.

That plan was the Medium Term Fiscal Strategy (MTFS), which brought new reforms, new reductions and an updated fiscal target calendar up to 2015.

Following, on March 9th and April 11th 2012 (based on the legislation they are governed by, Greek of other) the debt restructuring deal via the Private Sector Involvement (PSI) forced great losses on the assets of the Social Security funds, because of a legal connection between them and the Bank of Greece.

The former are obliged to keep a minimum of 77% of their assets in Greek Treasury bonds in the Bank of Greece and have therefore lost a huge part of their nominal value because of the PSI.

Stunningly, this was forced by an emergency law passed in 1950 by the King of Greece, Paul I, still valid at the beginning of this crisis.

It goes without saying, however, that because the credit standing of Greece had been reduced greatly, without the PSI there might have been a total collapse of the economy and therefore the funds' assets might have totally evaporated.

Finally, in October 2012, the MTFS was extended in order to cover the period up to year 2016 and the Memorandum of Understanding between the Greek Government and the Troika was updated.

The system layout

In Greece there are three pillars to the pension system.

Pillar II accounts for Occupational Schemes (IORPS) and Pillar III for Private Insurance.

Neither of the two is very popular though, thus the first Pillar, Social Security, accounts for more than 99% of the whole system.

The latter operated as a Defined Benefit Pay-as-you-go system until recently (DB PAYG) and provided three types of benefits: a main pension, a secondary (auxiliary) pension, lump sum amounts and provident grants (EKAS). The secondary (auxiliary) pension has now been turned into Balanced Notional Defined Contribution (see below under More Reforms).

The system used to work on 14-time a year deposits. People would be paid 14 times a year, contributions would be made accordingly and pensions were also paid 14 times a year.

The 2010 Reform

In 2010, under the MoU, the Social Security map changed drastically in Greece.

A new logic was introduced for the main pension. It was divided in two parts, a basic part, which is means-tested and serves as a safety net, and is paid 12 times year and a proportional part which is calculated as the product of the accrual rate by the past credits by the pensionable salary.

Accrual rates, formerly varying between 2% and 3% now vary from 0,8 to 1,5% thus reducing the over-generosity of the system.

The statutory retirement age, formerly maxed by 65 but effectively not more than 62, is now legislated to 65 for both men and women. It is also linked to the increase in life expectancy at age 65 from the year 2021, using the decade exactly before that as a reference period.

The indexation of benefits, formerly decided yearly by the Minister of Economy (MoE), is now legislated and cannot exceed the Consumer Price Index (CPI).

The full contributory period is now 40 years in contrast to 35 years before the reform.

Pensionable earnings used to be calculated on the 5 or 10 last years of a person's career, most of the times the ones with the highest wages, thus increasing the amount of pension. The new law requires that pensionable earnings are calculated on the whole career average. Thus, there is a motive given to everyone to declare that they are working so the black market is reduced, but also to declare the real wages they are paid so that their final pension amount is enough to cater for their needs when retirement comes.

The Public Sector also changes and civil servants who are hired after 2010 will be insured in the same fund as the Private Sector employees.

All disability pensions are re-examined case by case by a special committee, since a lot of false cases had been discovered.

The most important clause in the law, however, is the one that stipulates that between 2009 and 2060 the increase in Greek Public Pension expenditure must remain under 2,5% GDP. If long-term projections (to be run by the HAA every 2 years) show otherwise, relevant parameters of the pension system will be changed to bring the increase of expenditure below the targeted threshold. This clause makes the system a self-correcting one and makes it easier for future policy-makers to avoid long legal procedures in order to legislate towards the sustainability of the system.

More Reforms

In December 2011 a long-awaited revision of the list of heavy and hazardous occupations was made. Aiming at reducing substantially the coverage to no more than 10% of the employees, the new list includes almost 30% less workers. This was a long awaited reform for as technology went on, some jobs like confectioners, janitors and hairdressers did not belong to this category any more. Its effect has mainly to do with the legislation and thresholds on which the respective workers retire (more working days needed for pension, higher statutory retirement age).

Then, in March 2012, a vast reform of the auxiliary pensions was legislated. Many of the larger auxiliary pension funds of employees are merged into one (ETEA) and the old Defined Benefit system is turned into a balanced Notional Defined Contribution system, precluding any kind of fund transfer from the National Budget. Also, more pension funds can be added in the future upon their contributors' request. The remaining auxiliary funds became *ipso jure* private law bodies (Greek acronym is NPID) of mandatory insurance, hence a type of occupational funds with mandatory contributions as regards the Greek legislation. The funds which did not merge into the new mega-fund as of the first trimester of 2013 are only four.

Under the updated MTFS in November 2012, an extension of two years was legislated on the statutory retirement age, so the latter became 67 years of age in most cases. The statutory retirement age had already been linked to life expectancy in 2010, effective 2021. Life expectancy is expected to increase within the next ten years in Greece, however, during crises literature states that life expectancy drops so we may not have witnessed an immediate increase in the statutory retirement age unless reformed in 2012.

The cap of contributions of a large portion of employees was also changed with the above legislation, more specifically the people first insured before 1/1/1993. These people, having more than ten years in the market, earn relatively higher amounts than younger people and thus this change aims in a great contribution increase. Needless to say, the market always adapts to such legislation so it is expected that new agreements will arise so that people avoid the extra cost to any extent that they can.

The administrative reform of 2012-2013

As early on as 2008, efforts had been made to merge the plethora of Greek Social Security funds (133 at that time) to only 13. The funds were indeed merged but in reality, most of them operated independently, even though under a new name. There were many reasons for this. Some of them included a great difficulty in merging databases and accounting systems, as most of them had been purchased and operated differently by the different funds. Also, internal clashes between high-ranking officers and further bureaucratic and legal problems made it impossible for the system to be actually merged. Even in early 2013, some of the merged funds still operated with fiscally independent sub-funds.

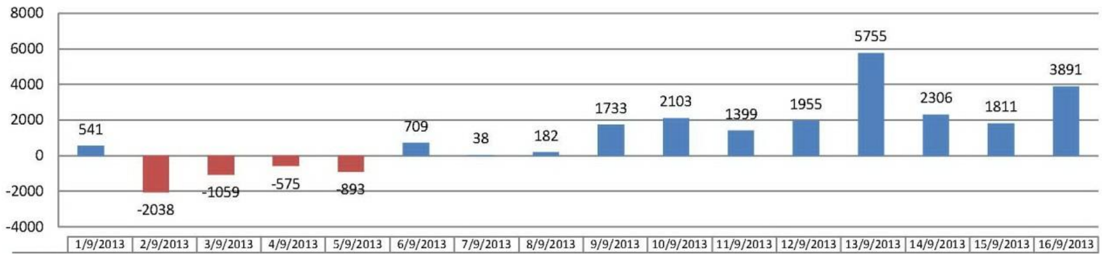
As this was realized in mid-2012, under the intense pressure of the Troika for clarity in the number and amount of paid pensions, the Minister of Labor (MoL) decided to overcome this problem by using the Social Security Number (SSN – Greek acronym is AMKA) , existent almost a decade by then, but never actually taken advantage of. The MoL asked that all pensioners have issued a SSN and that the computerized systems of all funds have incorporated this number before they pay pensions. This process took a few months and leveled off in June 2013, when the order was given to temporarily withhold all pensions for people who had not taken care of their SSN being issued and reported to the issuing fund of the pension.

The system which spawned from and supported this procedure was named “Ilios” – the Greek word for sun – and intends to shed lights on the GSSS. It led to the first – ever – full pension statistics report for the Greek public pension system. This report includes gross average income from pensions, an analysis of pension by category, pension amount by 500 euro brackets, an analysis by geographical distribution and by nationality. The report is hereafter prepared on a monthly basis by the Hellenic E-governance in Social Insurance Agency and can be found at its website.

Another important problem to be tackled was the one of the real estate owned by the Social Security funds. These vary from offices and hotels to hospitals and apartments, from camps to parking spaces and so on. Having collected all real estate in one dynamic database, where the current values as well as the renting price are systematically updated, it is much easier for these to be managed. In July 2013, the current value of all real estate assets of the Social Security funds reached almost 1,5bil. Euros. It is to be noted that the current value is different in most cases than the market value, with the latter being lower in many cases because of the crisis. The list of real estate assets will also be used in order to sell or rent a number of the latter. The above information along with many others can be found in the report analyzing the new database named “Estia”, after the Greek word for home.

Following, in September 2013, a new plan was devised in order to curtail contribution evasion. A system called Ergani, which includes all available data for employees, has been used to cross-check and provide information for employers and employees who avoid paying contributions. A deadline was given for September 15th 2013 to employers to declare all staff before new, very strict fines (10.550 euro fine for every employee found not insured, immediately effective) would be issued to offenders. This action bore fruit and also proved that there are still a lot of uninsured employees in the market. The diagram below proves exactly that:

Graph 1. Balance of new employments/layoffs for the first fortnight of September 2013



Immediately before the implementation of the new measures, new employments minus the number of people laid off have increased acutely. This illustrates that employers show some willingness to abide by the rules in fear of paying a large amount of money for contribution evasion.

The MoL announced in early November 2013 that further cross-checks are imminent, since the estimated contribution evasion for 2013 only amounts to one billion euros. The money earned from contribution evasion will be used – according to MoL announcements – to counteract further possible reductions demanded by the Troika, so that the fiscal gap of 2013-2014 in the pension system is filled.

Reductions

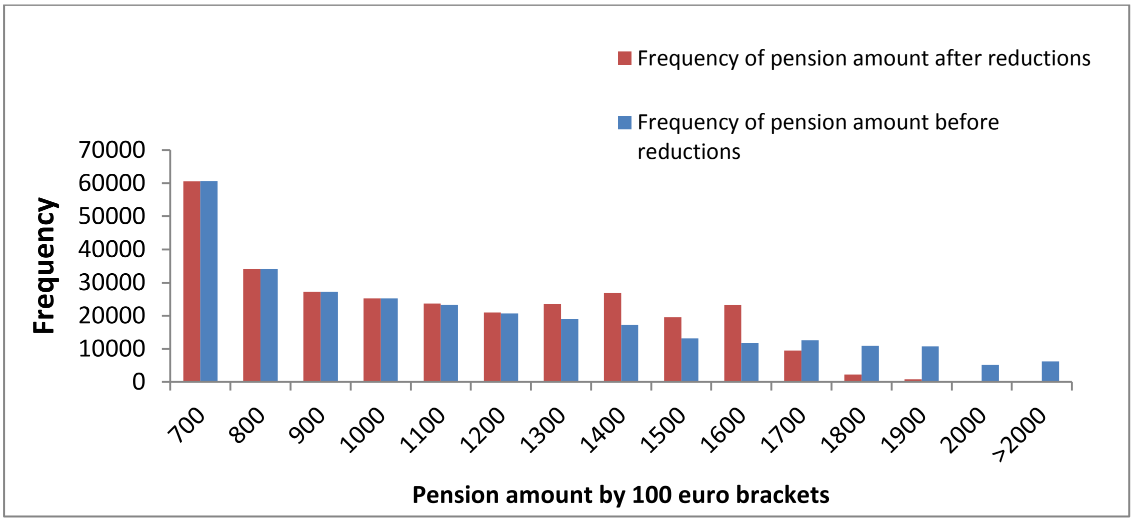
The cash-flow shortness in the Greek Economy soon led to a need for pension reductions, which began in 2010 and are permanent, except for the age-related ones.

At the same time, people who had retired very early comparing to the statutory retirement age and who had their pensions calculated on the generous accrual rates ranging from 2% to 3% were called in to return parts of their pension. These amounts of money were redirected to the Intergenerational Solidarity Capital, founded in 2007, or the respective funds' budgets.

Main pensions were reduced as much as 20% for the normal retirees and as much as 40% for the very early ones in each of the reduction rounds of which there are now twelve, not all applicable to everyone. Auxiliary pensions were reduced accordingly. In order to retain the social character of the pension system, however, reductions were not implemented on very low incomers or ones with disability or disabled family members.

The consequent reductions caused large pension amounts to become scarce and shifted them towards the average. For example, in the most populated fund, that of private sector employees, looking into December 2012 pension amounts (which do not include all of the rounds of reductions as the last round was implemented later in 2013) as opposed to the ones before the reductions, one can see the pattern mentioned before. In the following graph, pension amounts of less than 500 euros have been omitted so that the point is clearly made.

Graph 2. Frequency of employees' pension amounts by 100 euro brackets



To go on, under the updated MTFS in November 2012, lump sum amounts were reduced for the first time with percentages ranging from 2% to 83% and a further reduction of 35% possible with a ministerial decree. The reason for this was that people had been getting their lump sums for decades now based on certain formulas, without the fund always receiving the actuarial equivalent since this was a defined benefit system. Thus, as was the case in both the main and auxiliary pension, the previous generation received very large amounts which were backed by the demographic and fiscal situation of that time, and left the current retirees and the next generation with nothing but deficits.

Furthermore, the criteria for the Pensioners' Social Solidarity Benefit (EKAS) have been made stricter. As a result, about 5% of the beneficiaries lost their right to this benefit in June 2013. This was the result not only of the stricter provisions, however, but also of the newly adapted computerized system which recalculated all the pensions per person in June 2013. The latter made it possible to cross-check the total amounts declared by pensioners throughout all the Social Security funds and types of pension.

In another aspect of reductions, people of the previous generation are called in to return some of their pension amounts either because they retired earlier than they should have or because their pension is actuarially over-generous. This is done to promote intergenerational fairness but there is question about whether retrospective reductions to people already retired are legal in a defined benefit system. Looking into this question is beyond the scope of this paper and has been analyzed further in another publication of the author.

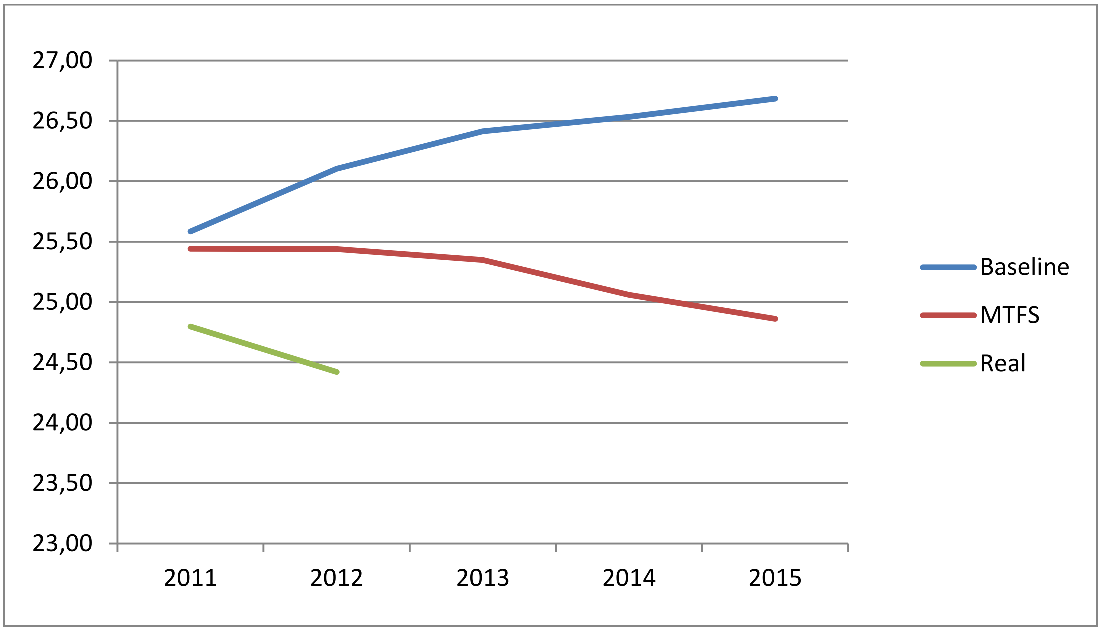
Further on, indexation was frozen for five years (2010-2014) and the tax allowance (personal exemption) was reduced by a quarter, from 12.000€ to 9.000€ for normal pensioners for 2012 income. Further tax allowance reduction was being discussed at the end of November 2012 and will most probably be applied on the 2013 income for all employees, freelancers and pensioners.

An interesting fact about the newfound legislation and its appeal to people is that when somebody visits the Daily Gazette website, they will find that the issues of reductions are in fact the ones with the most hits since September 2012. The Pension Reform of 2010 still remains in the top ten.

<u>The results of the Reform in terms of sustainability</u>

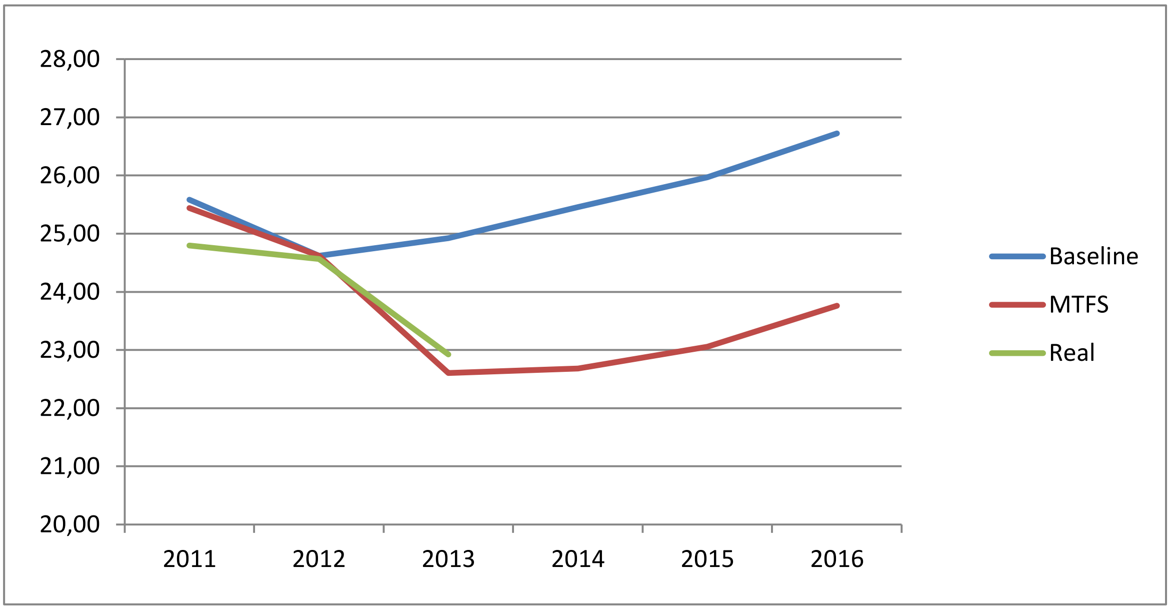
In the short-term the public pension expenditure was curtailed and remained under the targeted thresholds set by the MTFS until the end of 2012, while it slightly exceeded the targets set later, under the MTFS 2012-2016. Below one can see the expenditure predicted before the MTFSs, the target amounts set by both MTFSs and the ones realized.

Graph 3. Public Pension Expenditure in bil. Euros under the MTFS: Medium - Term Fiscal Strategy 2012-2015 (July 2011)



** 2012 projection is based on 8-month real data*

Graph 4. Public Pension Expenditure in bil. Euros under the MTFS: Medium - Term Fiscal Strategy 2013-2016 (November 2013)



** 2013 projection is based on 8-month real data*

***2011 figures are taken from the MTFS 2012-2015*

Because of the debt restructuring deal there has been an 8.3 billion Euro loss in nominal value of the bonds. As regards their market value, this will fluctuate and only at the time of selling will we be able to exactly calculate the loss anticipated. However, in this time of cash flow shortness it is very probable many of these funds have to liquidate part of their assets in order to provide for pensioners, hence causing an actual, sizeable loss. Unfortunately, this has been a great con in the otherwise positive outcome of the Greek debt restructuring, and will probably pose a threat later on in the system.

Sadly, exactly the same thing happened to individuals who have trusted the Greek treasury bonds for their savings. Many measures have been proposed to balance this loss, like tax reductions. However, none of these have been legislated yet. The only light at the end of the tunnel is the fact that, because of the slight rebound of the Greek economy, the Greek treasury bonds have gained back a lot of their nominal value in November 2013.

In the long-term*, the fiscal impact of the 2010 reform seems to be alleviating the Budget from a great deal of public pension expenditure. The Hellenic Actuarial Authority presented actuarial valuations for the Greek public pension expenditure for the years 2007 to 2060 in 2008 and for the years 2010 to 2060 in 2011. These were included in the 2009 and 2012 Ageing Reports respectively. In the first case, as can be seen below, the increase in public pension expenditure would have been 12,4% GDP, leading as mentioned before to 24% of GDP for public pensions in 2060. In the second valuation, however, the projected increase amounts to only 1% of GDP.

** Long term projections are based on the results provided for the Ageing Report 2012 and typically include the reforms up to September 2011.*

Table 1. Greek Public Pension Expenditure to GDP, as reported in Ageing Reports 2009,2012

	Public pensions to GDP
2009 (2007-2060)	12.4
2012 (2010-2060)	1.0

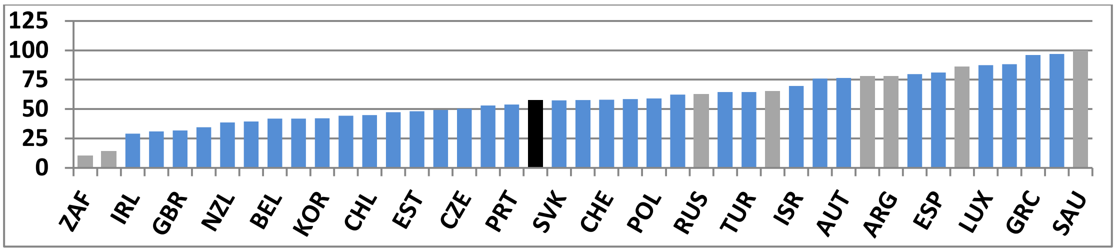
This result also makes Greece comparable to both the 27 European States (EU27) and the States of the Euro Area, as can be seen. Greece has the same public pension expenditure increase as the Euro Area states, and one third less than the EU27.

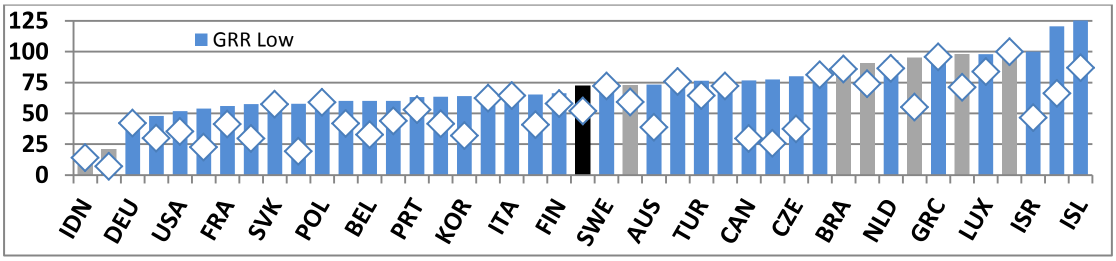
Table 2. Comparison between Greece, EU27 and the Euro Area as regards changes in the Public Pension Expenditure to GDP per decade

Expenditure	2007/2010	2020	2040	2060	Change 2010-2060
Greece 2007	11.7	13.2	21.4	24.1	12.4
Greece 2010	13.6	13.7	14.9	14.6	1.0
EU27	11.3	11.3	12.6	12.9	1.5
Euro Area	12.2	12.3	13.9	14.1	1.0

Regarding the gross average replacement rate, it used to be close to 100%, thus implying that the first pension of the retired was almost as much as their last wage. This meant that the importance of the last years of contributing was unequally important to the rest of the years in one’s career.

Graph 5. Replacement rate of social security pensions (in %) –
OECD Pensions at a Glance 2011 (Medium, low and high wage earners)





On a different definition of the gross average replacement rate** used by the Ageing Working Group, the reform reduced the former by as much as 20%, reducing the over-generosity of the system. Since the whole working career is taken into consideration under the new legislation, the replacement rates become smaller in the first decades and then the phenomenon levels off as the whole career average becomes the norm in calculating the pension.

Table 3. Gross Replacement rate of social security pensions (in %) – AWG Reports 2009,2012

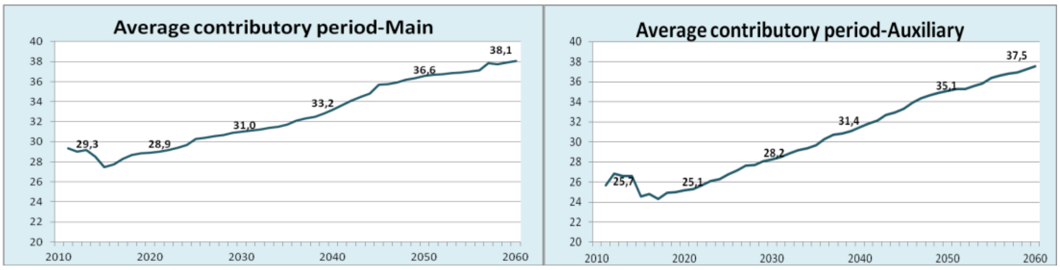
	2020	**2030**	**2040**	**2050**	**2060**
2010 projections	48.1	46.1	46.2	52.4	49.6
2007 projections	67.9	70.7	67.8	70.0	66.5

***The gross average replacement rate at retirement as used in the AWG projections is the ratio of the first pension of those who retire in a given year over the average wage at retirement. The (economy-wide) average wage of old people at their retirement usually differs from the overall economy-wide average wage, unless a flat wage profile over the entire working career is assumed in the projection exercise.*

The reform also pushed the average contributory period upwards for both the main and auxiliary pension schemes.

Starting from almost 30 and 26 years respectively as the auxiliary pension system is not yet fully mature, the contributory period is driven to 38 years for both in 2060.

Graphs 6,7 Average contributory periods for Main and Auxiliary pensions 2010-2060



The implications of the reforms

Even before the 2010 reform, with relatively high pension expenditure, one out of five old people were poor in Greece, according to the OECD.

At the same time Eurostat figures show an upward trend as regards at-risk-of-poverty rates for pensioners for the years 2010,2011.

Table 4. At-risk-of-poverty rates for pensioners 2007-2011, GR, EU15, EU27

At-risk-of-poverty rate for pensioners (SILC) (% Total)					
	2007	2008	2009	2010	2011
EU (27 countries)	16,6	16,2	15,5	13,9	14
EU (15 countries)	17,4	16,5	15,5	14,2	14,5
Greece	21,5	20,3	18,4	19	19,9

The number is expected to increase further for the years 2012, 2013 because of the legislation passed. More specifically, the special grant given to pensioners whose yearly income does not exceed 4.320 euros (EKAS – for single people, starting January 2013), has been reduced greatly from the year 2010 and the prerequisites for receiving it have been tightened (see above Reductions). All other age-related means-tested grants are now being incorporated into EKAS and further reductions are planned.

There is, therefore, the question of whether the low-income pensioners will be able to get by on their pensions and the EKAS. Even though means-tested criteria have been applied before the reductions, their efficiency is questionable when looking at the above statistics.

Another aspect of the pension reductions which were combined with wage reductions is that they led to a decrease in contributions, causing cash flow problems in the short term as we are talking about a PAYG system.

More importantly, in 2011 there was a reduction in funds transferred from the General Government to the Social Security funds which amounted to 3,85bil.Euros, amounting to 15,4% off, in comparison to 2010. There was, however, a loss of 2,57bil Euros in contributions due to the heavy recession and unemployment. This means that what is gained from pension reductions is almost lost in contributions since people lose their jobs by thousands and therefore do not contribute to the system. Therefore, unless a way to overcome unemployment is found and implemented, a vicious circle of pension reductions because of low contribution accrual is created and perpetuated. A loss of 0,8bil Euros was witnessed in 2012 in comparison to 2011 as regards contributions, as opposed to a reduction of 2,7bil Euros being transferred from the General Government to the Social Security funds.

Concluding Remarks

Greece has gone a long way towards laying the foundations for more sustainable pensions, not only limiting the superfluous, but sacrificing at the same time a part of the essential.

It was, without question, an important and necessary action. However, since real people lie behind the numbers, it is vital that adequacy is also guaranteed, so that the people reaching the third age are able to manage with integrity and pride. As it is, of course, each individual's responsibility to cater for an adequate pension by contributing to the system continuously throughout their life and investing on the side on other pension products. The main driver for reform in 2012 and before was the output of the Ageing Working Group in sustainability. In the upcoming round (2015), the Group is anxiously expected to make adequacy its priority.

The reforms have not finished, nor is it possible to reform a system in three years, when nothing has actually been changed for decades. The fiscal situation of the Greek Government accelerated the former, but as things are falling into place, it is time to trace back the steps and deal with the problem universally.

It is time for the Government to distinguish between welfare and pension, to educate people on the demographic developments and the utmost importance these play on their pension income when they retire in a few decades, as well as face the fact that DC systems are – in most countries – and should be – in Greece also – a part of everyone's third age income.

These actions need time and trust, a key element absent in the Greek political scene at this point. Respecting pensioners in actions rather than words, eliminating former inequities and providing reparation for some of the injustices of the last three years are good starting points, although there is still a lot to be done so that we finally sail clear of the iceberg.

Note: Further reforms discussed at the end of 2013 are not incorporated as they have not yet been legislated. The Greek pension reform is ongoing; hence anyone with special interest may contact me for updated of the paper.

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Labor Legislation Bulletin

Greek Press

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