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# **Vacillations around a Pension Reform Trajectory: time for a change?**

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# Vacillations around a Pension Reform Trajectory: time for a change?

Platon Tinios<sup>#</sup>

## ABSTRACT

Discussion of pensions in Greece displays a paradox: reform is universally acknowledged to be important, urgent and mature, yet the political class avoid and postpone all discussion. This results in a syncopated reform path. A historical overview indicates that reforms are best understood as interrupted and unsuccessful attempts to complete the original blueprint for the pension system which was formulated in the 1930s. These define a reform trajectory around which there exist centrifugal forces pulling away (cross-subsidies), and homeostatic mechanisms bringing back on track (public finance). Thus, the *original* 1930s design is implicitly accepted as a maximal aim of reform, while the question of its appropriateness is never raised. This analysis explains reform failures by problems in the content and preparation of reforms, rather than on the strength of opposition (which, in any case, was highly predictable). A fresh start, provided there is adequate preparation, is a possible way out of the impasse.

Keywords: Greece; History of the welfare state; Social Security; Pension reforms.

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## Vacillations around a Pension Reform Trajectory: time for a change?

### 1. A Perennially Open Reform

The year 2007 was to usher in a major pension reform in the next year, or, so the Government had solemnly declared. The stirrings of a social dialogue were in place, a committee having been formed in the usual way. Yet, and in contrast to a tendency to mark the passing of even minor events, two anniversaries crucial for social security were allowed to pass in guilty silence. *First*, and most importantly, was the 70<sup>th</sup> anniversary of the operation of the major social insurance fund, IKA, marking the beginnings of modern social insurance in the country. A short piece in a newspaper was the only remembrance of the start of modern social insurance in December 1937<sup>1</sup>. *Second*, October was the 10<sup>th</sup> anniversary of the publication of the ‘Spraos Report’ (Spraos Committee, 1997). The report had shocked public opinion by arguing forcefully that decisions had to be taken to meet both current and future problems; it had mentioned that the structure of the social insurance problem facing the country was such that ‘*it had until 2007 to decide*’, in the sense that dramatic deteriorations were expected to occur around that date<sup>2</sup>.

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<sup>1</sup> Tinios (2007) a comment in Eleftheros Typos daily newspaper (3 December 2007).

<sup>2</sup> That ‘time of reckoning’ or else ‘closing of the window of opportunity’ (sic) was postponed by the large immigration flows. See Tinios (2003) for details. For the Spraos Committee and its reception see Featherstone et al (2001).

Both anniversaries would have been ideal opportunities to ponder over the effectiveness of the social protection system as a whole. Yet, both anniversaries were resolutely ignored. In October 2009, the 75<sup>th</sup> anniversary of the 20<sup>th</sup> century's major social insurance legislation (Law 6298/1934) met a similar reception. When faced with pension issues, the political class exhibited, once again, a preference not to think or argue, an inability to explain motives and answer for choices, a guilty prescience that the same mistakes were about to be repeated.

A further vignette adds to the flavour of official and public attitudes. In March 2009 the '*Excellence Group*' of Experts under the Prime Minister's adviser on Public sector reform released their first report. The experts had collected, through a process of brainstorming, the 26 '*most pressing and feasible reforms*' facing Greece. The reforms were ranked by a process of decentralised voting where each expert awarded a 1 for the most urgent reform and on to 26 for the least urgent and/or feasible reform. "*Social insurance reform with social sensitivity*" scraped in at number 25, just above the last reform which was "*Recycling of refuse*".<sup>3</sup>

Yet, official publications of independent bodies (Bank of Greece, EU etc) concur on a list of pension woes which can be summarised under five headings.

The Greek pension system:

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<sup>3</sup> Axiotis Group (2008). In a letter to the press, the chairman of the group makes clear that the low rank is a result of the absence of the administrative prerequisites for reform, hence clearly placing an emphasis on 'feasibility' rather than 'urgency'.

1. **Is Costly.** Currently pensions absorb more than 12% of GDP (OECD 2007).
2. **It faces dramatic demographic challenges.** The dependency ratio is expected to deteriorate at the second fastest rate amongst the EU-15, while Greece faced the highest expected pension expenditure in 2050, almost a quarter of GDP.
3. **It is economically inefficient.** A multitude of separate providers and special regimes leads to a patchwork of cross-subsidisation and non-wage costs. The private sector and exports shoulder the brunt of the cost while the public sector retains its privileges.
4. **It is socially ineffective.** Official reports admit that ‘poverty is grey in colour’. Old age poverty is some 50% greater than for working age groups. Once the population shifts from the vicissitudes of the globalised labour markets to the bosom of the Welfare State, their risk of poverty appears to increase (Lyberaki & Tinios 2007).
5. **It is resistant to change.** At least since 1990 the pension system is under threat of a major reform which is always postponed, in a perennial ‘Reform by Instalments’ (Tinios, 2005). Nevertheless, the system architecture remains substantially that of the Founding Act of social insurance in 1934.

It is thus not surprising that in lists of urgent reforms compiled *outside* domestic political constraints (e.g. Bank of Greece, OECD, EU), the reform of pensions is ranked very near the top. Only months after the Minister of

Employment declared that the latest instalment of March 2008 had '*solved the problem for a generation*', the Bank of Greece is asking for more (Bank of Greece, 2009) as is the OECD (OECD 2009).

This paper focuses on the paradox of reform proposals, which are urgent and mature; yet, the political class is doing its best to deny. The first aim is to explain the syncopated nature of the reform progress. The paper argues that reforms over the last half-century are best understood as piecemeal attempts to implement and complete the original blueprint for the pension system formulated in the 1930s. The course of reform is seen as a series of interrupted attempts to implement a given and unchanging target system. These define a trajectory around which there exist centrifugal forces pulling away, and homeostatic mechanisms bringing back on track. This analysis serves as a prologue for the second aim of the paper: the absence of real discussion of pension issues is attributed to the implicit and unquestioned acceptance that the appropriate course is simply to implement the *original* design of the pension system. Little thought is devoted to whether a 75-year old blue-print remains appropriate. This impasse signals the importance of fresh start in pensions discussions. Discussions need to move away from '*how to fix the old system?*' on to '*how to cope with problems of the future?*'.



## **2. The Political Economy Approach: vacillations around a reform trajectory**

The Greek Social protection system marks in 2009 the 75<sup>th</sup> anniversary of its founding charter, Law 6298 of 1934<sup>4</sup>. The formulation and passing of this law was by no means easy: it was associated with the demise of *two* centre-left governments and was finally passed as a compromise by a Popular Party government in 1934<sup>5</sup>. The 1934 law replaced an earlier law (L5733/1932, passed yet never implemented), which had met determined opposition by the medical profession, trade unions and the pre-existing occupational pension funds. The central issue at stake was the fate of the pre-existing funds: would they be consolidated into a unitary social insurance body, which would cover the entire population – as both economic theory and the blueprint composed by the League of Nations experts had intended? Or, would the separate pre-existing funds be allowed to continue – as the ‘social partners’ of the time preferred? The law that finally passed was a compromise between these positions – a compromise that is still shaping the landscape of social insurance 75 years later<sup>6</sup>.

Law 6298/1934 led to the opening of the first two IKA offices in Athens and Thessaloniki in 1937 (by the Metaxas dictatorship). Implementation was interrupted in the 1940s and social insurance was restarted by Law 1846 of

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<sup>4</sup> The Appendix (II) provides a chronology of social insurance in Greece in tabular form.

<sup>5</sup> For an impassioned analysis of the passage of the law and the compromises that led to it, see Tsalikis (2008) – a translation in Greek of a PhD dissertation defended at the LSE in April 1967. Liakos (1993) covers the same ground. Also, Agalopoulos (1955), pp18-31.

<sup>6</sup> See Papantoniou (1963) for an insightful early analysis of the IKA law. Also Tsalikis (2008), chap7.

1951. Nevertheless what Tinios (2008) calls the “Founding Vision of IKA” retained its three central characteristics:

*First*, IKA as the backbone and central pillar of a universal PAYG state system of social insurance – founded on building up rights through the payment of contributions by employers and employees.

*Second*, the functional links between short-term benefits such as health with more long-term benefits such as pensions. Health benefits constituted a visible and immediate improvement motivating the payment towards the more distant (and ultimately more important) pension benefits.

*Third*, and most crucially, the evolutionary implementation of the first two characteristics. Rather than enforcing obligatory consolidation of all employees in IKA, the law allowed their gradual integration over time. Integration was expected to proceed gradually: *geographically* (IKA spread from the major urban centres outwards over the following 2-3 decades) and, most crucially, *occupationally* (by incorporating pre-existing occupational funds). IKA was designed to operate as the centre of gravity and the pole of attraction of the overall system, attracting occupational groups on the strength of its better benefits and surer financing.

It is clear from much of the early discussions of the matter (see e.g. Agalopoulos 1955) that this process of consolidation was expected to proceed to its final conclusion relatively swiftly. Fragmentation was thus treated as a

transitory problem that was adequately dealt with. Yet, two generations later, most analysts cite it as the defining characteristic of the Greek social insurance picture (Petmesidou 1991; Börsch-Supan and Tinios, 2001; Featherstone and Tinios 2001). The number of separate social insurance funds from 153 in 1956 peaked at 325 in 1997 (Tinios 2001); consolidation since then has concentrated on administrative changes, whilst retaining the differences in the insurance terms offered to separate occupational groups within the same entity. It is notable that, even within IKA, in 1997 85% of new pension applications were able to cite some more favourable ‘exception’ to the rules; only some 15% unfortunates had to make do with the general rules (Tinios 2003, p 62). This process of obscuring differentiation by folding pension funds within wider units was continued by the most recent law, Law 3655 of 2008<sup>7</sup>.

All in all, one cannot but agree that the evolutionary process of consolidation foreseen in the IKA vision proved a resounding failure. An official Ministry of Coordination report, composed in 1958, concludes that there exists “absolute inequality of protection so that the constitutional principle on citizens’ equality has been totally forgotten” (Ministry of Coordination, 1959), an estimation that forty years later is still considered a commonplace (Marinos et al, 2007). Social insurance reform remains on the agenda in 2009, while it makes its reappearance with equal urgency and regular periodicity.

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<sup>7</sup> In the majority of cases the 2008 law consolidates the management of funds, retaining all separate social insurance terms and even keeping separate accounts.

Thus there are three aspects to be explained: *First* the delay and ultimate failure of the evolutionary process foreseen at the start of the ‘IKA Vision’. *Second*, the syncopated nature of serial pension reform – where pension discussions return with apparently equal force. *Third*, the periodicity and cyclical nature of the reform episodes. The mechanism proposed to explain this process involves a central reform trajectory mapped out in the IKA vision, whose object was to complete matters left undone in 1934. Around this trajectory operate, on the one hand, *centrifugal* forces pulling away from the reform path and, on the other hand, *homeostatic* mechanisms attempting to restore the reform path. A key feature is the relative impermeability of the whole process, which simply repeats itself regularly. This syncopated political process of reform was described by Tinios (2008b) as ‘ostrich interventionism’ – viz. episodes of denial of the existence of a problem interrupted by frantic activity leading to the passage of a law. These matters will now be considered in turn.

The *centrifugal forces* were embedded in the mechanism at the very start of the evolutionary process and are innate to it. A decision to proceed gradually created the conditions for a ‘prolonged immaturity<sup>8</sup>’ of the system as a whole. As social insurance spread progressively through the population (at both the extensive and intensive margins<sup>9</sup>), it generated *current* surpluses as the stock of

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<sup>8</sup> In social insurance systems expanding coverage leads to an immediate increase in contributions which is transformed into greater expenditure as new pensioners gradually claim the new benefits. In such ‘immature’ systems there will be current operating surpluses even if the long term (actuarial) balance is heavily negative.

<sup>9</sup> Borrowing the terms from D. Ricardo, the extensive margin would involve the spread of social insurance in the population; the intensive the addition of new layers of protection. The end of the extensive margin came in 1998 with the payment of contributions by the farmers. The edges of the *intensive* margin were explored by auxiliary pension coverage, separation payments within

contributors outweighed the flow of new benefits (which needed time to build up). The existence of surpluses (combined with lax actuarial control<sup>10</sup>) created euphoric conditions in which to spend the cash generated.

Pension arrangements thus placed in the hands of governments a valuable ‘governance tool’. Denial of the use of that tool in the 1960s and 1970s seemed at the time impractical and perhaps even irresponsible, by placing distant interests above immediate and worthy priorities. The process was legitimized by what might be called ‘Second best economics’, and ‘second best politics’. *Second best economics* involved pragmatic solution to medium term problems. Such were the use of social surpluses from the 1950s to 1970s to finance industrial development. Less easily defensible, yet no less widespread, was the use of cross-subsidies to aid particular sectors<sup>11</sup>. In a similar vein, ‘second best politics’ would involve pragmatic solutions to pressing political problems by accommodating groups through ‘special dispensations’<sup>12</sup>, often hidden in the small print of otherwise incomprehensible legislation. A key problem of second best solutions in economics is known to be the entrenchment of the conditions preventing the first best, or their persistence long after the distortion necessitating them has ceased to hold. In the case of pensions, fragmentation

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occupational groups, whereas consolidation of protection between occupational groups usually leads to improvement in coverage.

<sup>10</sup> Tinios (2010a) relates how Greek accounting standards allowed public enterprises to hand out pension privileges, to justify them as social policy and evade any notion of budget constraint.

<sup>11</sup> Börsch-Supan and Tinios (2003). Tinios (2008) defends the practice of diverting social insurance surpluses to industry as within the spirit of the time. Nevertheless, a more transparent mechanism would undoubtedly have served both social insurance and industrial investment better.

<sup>12</sup> E.g. a favourite way to avoid incomes policies was to secure pension privileges or contribution holidays for favoured groups – e.g. civil servants were excused their contributions in the 1950s. Bank employees’ contributions were paid by employers as a result of collective bargaining in the 1980s. Both privileges were rescinded by Law 1902/90. For a review of the period as a whole see Kazakos (2001).

and the ability to strike separate deals were put to use by governments, elevating in this way pension arrangements as a key instrument in clientelistic politics. At the heat of decisions, most governments excused themselves from remembering that the ‘resourceful solution’ to their immediate problems exacerbated the fragmentation of the social insurance system and moved it further away from the attainment of the evolutionary attainment of the IKA vision.

The system was not *totally* derailed due to the operation of **homeostatic mechanisms** which favoured the return to the original goal. Any social insurance system implies the existence of ‘guardians’ – i.e. cadres aware of the long term importance of the completion of the evolutionary project. Such individuals should play the part of ‘whistle blowers’ when the long term is mortgaged to immediate concerns. Indeed, the ‘first generation’ of social insurance operatives were keenly aware of the importance of the completion of the project and the need to consolidate<sup>13</sup>. The Ministry of Coordination published an influential report in 1958 (Ministry of Coordination 1959). Some of the same people worked on a blueprint of social protection reform in the politically troubled times of the sixties. The imposition of the dictatorship interrupted their work, while their excellent report was published without attribution of authorship by the Royal Research Institute in 1970<sup>14</sup>. The tail end

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<sup>13</sup> The early history of social insurance did not yet display the shortcomings that Sotiropoulos (2007) mentions as characteristics of public administration. Social insurance was lucky to be served in its first steps by people such as E. Papantoniou, P.Tsoukatos, F.Hatzidimitriou and others. The political contribution of Y.Pesmazoglou was as a beneficial influence in the early steps of social insurance.

<sup>14</sup> Royal Research Institute (1970). This report was the first to treat social policy as a whole.

of the influence of the early group of reformers may be seen in the failed attempt by L. Patras to pass a pension reform law in 1970 during the dictatorship<sup>15</sup>. The impact of inflation and the concern over short-term issues intervened in the 1970s. When discussion of these issues returned in the 1980s, the thread with the original aims of social insurance appears to be lost<sup>16</sup>, and fragmentation is treated as a part of the status quo, 'a fact of nature'.

Nevertheless no pension system can rely exclusively on good intentions. The original law (both in its original form and as reformulated in 1951) foresaw the problem and embedded mechanisms to return to stability. The problem with immature PAYG systems is their lack of a budget constraint (Tinios 2005); it is the function of regular actuarial reviews to play such a role. Such reviews were foreseen in the original legislation, a requirement repeated in subsequent legislation (e.g. L2084/92). Despite the legislative provision, actuarial reviews were seldom undertaken, and when they were, they were simply ignored<sup>17</sup>. The process of 'promoting immaturity' kept the wolf away from the door up to the early 1980s: the extension of compulsory auxiliary coverage to all employees in 1983 was the last major attempt to generate new current surpluses. After that, IKA and other funds were structurally unable to cover their current expenditure and were forced to resort to banks for short-term lending to finance pensions. This state of affairs in 1987 was superseded by the regular payment

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<sup>15</sup> That attempt was deemed to have foundered when it was realised that army officers would have to be included in the ambit of the reform Sotiropoulos (1999).

<sup>16</sup> The Spraos report of 1997 (Spraos Committee 1997) was to some extent a conscious return to the whistle-blowing tradition.

<sup>17</sup> Law 2084/92 holds that actuarial reviews are obligatory for every fund every 5 years. Nevertheless, actuarial reviews were typically undertaken only by Separation funds who to increase their payouts. No guidelines were ever issued.

of government grants to finance pensions (Tinios 2003): today around 30% of all pensions are financed by *ad hoc* government handouts. This practice effectively abolishes the budget constraint to social security by severing any link between benefits and income. As a third is covered by the State anyway, any *individual* benefit increase may be granted independently of finance and charged to the State grant.

The direct involvement of the Government budget turned pension fund independence into a fiction, yet upgraded social insurance deficits as key determinants of the government deficit. Government finances became the dominant homeostatic mechanism. This brought to the fore as key actors in social insurance reform, international organizations such as the IMF and the OECD, and later on the EU (Tinios 2000, 2002). As their interest focused on public finances their viewpoint was by necessity macroscopic. They treated the social insurance system as a unit rather than a collection of independent autonomous entities and were instrumental in bringing the matter of consolidation to the attention of public opinion<sup>18</sup>. Nevertheless, little awareness was generated as to how the *macro*-economic financing issues were related to *micro*-operation of social insurance in the separate funds<sup>19</sup>.

How did the counteracting influences of centrifugal forces and homeostatic mechanisms play out in practice?

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<sup>18</sup> Notably by the publication of analyses, e.g. IMF in 1992, OECD in 1998, OECD 2007. The Open Method of Coordination is also part of this process forcing the examination of the system as a whole.

<sup>19</sup> Indeed, some extra confusion was generated by the operation of the so-called 'white hole'- the accounting mechanism through which the deficit on a public finance basis is transformed into a surplus on a cash basis, supposedly through the increase in cash holdings of unnamed social insurance institutions and local authorities.



*'Ostrich interventionism'* consists of regular episodes of frantic intervention to satisfy outside pressures followed by a Nirvana of abandon (Tinios, 2008b). Since the early 1990s pension reform episodes go through a number of phases:

- Pressure builds up *outside* Greece to 'do something' to reduce government deficits.
- Public opinion and the media 'discover' an immediate threat to pensions, usually voiced into headlines such as 'Pension Funds are sinking', 'Pensions under threat' etc. These headlines may or may not be accompanied by data (most frequently demographic projections).
- 'Social dialogue' ensues which lasts a few weeks. The dialogue is marked by confusion, strikes in the public utilities and frantic side negotiations with separate groups of workers.
- Laws are passed with great haste. They are hailed as of 'epochal importance'. The laws keep the structure of the system and inch along in the direction of the original reform trajectory: somewhat lesser distance dividing groups, slightly later retirement ages, and slightly fewer exceptions. Such laws were passed in 1992, 1998, 2002 and 2008<sup>20</sup>.

The unique feature of this process occurs between the reform episodes. The whole system passes into a denial phase, where everyone talks and behaves as if there never was a threat to pensions. All processes of reflection are prevented

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<sup>20</sup> Where there was meaningful change, which was presented as independent of pension reform: Means testing in 1996 was a (regrettable) necessity imposed by austerity. Changes to banks' pensions in 2005 were forced by International Accounting Standards. Both cases were characterised by depth of preparation. The banking methodology was subsequently used as a model by the European Commission for State Aid cases in the French public sector (Tinios 2010a).

and any call to reform is maligned. The example of the Spraos Committee is very characteristic of this process (see Featherstone 2001). The treatment of the Spraos report meant that it had no emulators. The same pusillanimity implies that no political actors can withstand a possible accusation that they are preparing for a pension reform. Consequently, all technical preparations for future reforms are prevented. When the call comes from outside to start the process afresh, everyone behaves as if a natural catastrophe has struck. Given the short institutional memory of the political system, each reform episode is treated '*as if it was the first time*' - an interesting case of Serial Reform Virginitly.

The periodicity of this cycle appears to be of the order of 5-6 years, straddling two parliamentary terms. The first parliamentary term after a reform episode passes by trying to forget and to heal the wounds of the reform. This allows sufficient time for pension deficits to build up and leads to the first calls from outside to 'do something' close to the end of that term. Exorcism of the issue continues past the election (during which pensions are only mentioned in the context of increasing as being too low); the post-election government discovers to its horror that it must do something to allay outside pressures.

Giannitsis (2007, p.19) states that pension reform is 'a tragedy in many acts'. The analysis above, in contrast, suggests something closer to repeated showings of a popular comic opera. The leading parts are taken by the same actors, whose roles are tightly scripted and reactions carefully choreographed.

Social dialogues are set to favourite themes, the theatrical exits after *pas-de-deux* eagerly awaited. The parliamentary climax and triumphal ministerial declarations of eternal salvation bring down the house at the end of each performance<sup>21</sup>.

The repetition of the show may be attributed to a '*société bloqué*'. Nevertheless, the fact that the plot turned in 1992, 2001 and 2008 almost at the same points, while actors tend to stick to their roles, lead to a suspicion that a catalyst to give the plot, for once, a new twist ought to be *there – somewhere*. The predictability of reactions can possibly be stage-managed in such a way, as to produce a new play with a different ending.

The fault may not be with the *actors*, but with the *play*. The failure of reform lies in the preparation and contents of the reform package and not in the violence of reactions to it<sup>22</sup>.

### **3. Taking Stock: do we need a *new* pension reform agenda?**

The 75<sup>th</sup> anniversary of social insurance in October 2009 will find the country with a pension reform law which is barely 18 months old. The Minister of Employment had in March 2008 declared that the '*problem was solved for a*

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<sup>21</sup> Featherstone and Tinios (2006) relate how the interests of key actors (Government, Unions, Employers, finance, the policy community, cadres of pension funds) lead to a policy log-jam. The possession of an electoral system with strong parliamentary majority is not sufficient to guarantee that change can occur (Triantafyllou 2006). Matsaganis (2007) looks at the role of unions. Mossialos and Allin (2006) look at the related issue of health care reforms.

<sup>22</sup> This analysis of pensions concurs with Monastiriotis and Antoniadis (2009) view that it is the quality of reforms that is largely to blame for their failure, and not vested interests.

*generation*'. In the face of calls for more reform, it is pertinent to ask “Which problem was solved?”. Fragmentation of the system and fragmentation of control implies that pension reform may be interpreted or misinterpreted in three ways:

1. **As a redistribution *between* generations**, viz. as an actuarial issue. To correct this, one must look at the very long term and attempt to deal with debt dynamics. This viewpoint should interest the contributor who is concerned with providing for his/her old age.
2. **As a redistribution *within* a generation**, viz. as a public finance issue centred on the question of ‘*who pays for pensions?*’. Thus, a medium term perspective is favoured and the focus is on the Public sector deficit. This is the viewpoint naturally adopted by the Ministries of Finance.
3. **As a redistribution of political influence**, a question relating to the day-to-day governance of the system. Fragmented laws in over-determined systems demand constant attention; overlapping laws and jurisdictions necessitate frequent direct political intervention. This very short term perspective naturally interests those entrusted with operating the system – viz. pension fund managements and the Ministry of Employment which supervises them.

The last attempt at reform (Law 3655/08) was clearly oriented towards (3) and left the other two concerns unanswered. The law could be seen as a direct reaction to the fallout of the 2006 scandal of exorbitant fees charged to pension

funds for investments in derivatives, during which the Minister of Finance famously bemoaned the existence of '*clueless management teams*' in funds. Given that no political actor dared to mention factors *other* than day-to-day control issues, one cannot but agree with the Minister's statement regarding the particular solution to *that* pension problem. However, it is *also* true to say that issues 1 and 2 relating to intergenerational and public finance concerns were untouched. They remain to be discovered by future instalments of reform.

It is thus appropriate to persist with the question that was so deftly dodged by ignoring the two anniversaries mentioned at the start of this paper: *if we take the long view, how far along are with the implementation of the original IKA vision?*

Given the preceding discussion, it will come as no surprise to claim that the 1930s project is, in major respects, still pending:

- The original 1930s intention was that the statement '*We are being folded into IKA*' would have the meaning of relief and satisfaction. Instead, in 2009 it is most often used as a call to arms – as in some of the strikes in 2008 or in the context of banking pension reforms in 2005.
- In many ways the system is more fragmented than the situation at the outset. Fragmentation *within* organisational entities –fragmentation in insurance terms– is in some ways more damaging to economic efficiency than fragmentation in bureaucracy.

- Some of the second best solutions over the decades have compromised the original design in salient ways. For example, the original intention was clearly to deal with old age poverty by encouraging long contribution periods. Indeed a full career will lead to replacement rates comparable with those in the EU. Sharply raising minimum pensions (as was done between 1978 and 1985) dealt with the immediate problem but undermined the central philosophy of the original legislation<sup>23</sup>. Similarly, basing health care on a National Health Service severed the link between short and long term benefits.
- The system is increasingly moving away from self-financing. The State provides any shortfall between revenue and expenditure and has become the ultimate provider of all benefits. The courts take an equivalent position judging a variety of cases independently of economic logic or budget constraints.

Looking at the content of pension reform discussions, they proceed as if pension reform is a basket whose contents are fixed and unalterable. Reform is mentioned and treated as an amorphous whole, as if there can be no argument of what it is to comprise and no strategic choices to be made. Concrete proposals usually turn out to be simple parametric changes around a given system. Most ‘proposals’ amount to demands for a free lunch: curbing contribution evasion, reimbursement for foregone earnings due to the

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<sup>23</sup> Given that 70% receive the minimum pension the system collects revenue as social insurance and pays out benefits as a welfare system (Tinios (2001)). This provision acts as a massive evasion incentive.

misappropriation of social security surpluses. Those who dare to propose something draw from a fixed menu of measures: consolidation into fewer funds, raising of retirement ages, abolition of the most glaring privileges (e.g. Heavy and Unhygienic Occupations), changes to the gender bias. It is interesting that the changes are always *enumerated* and never *evaluated*. Everyone appears to know what needs to be done, so that concrete changes are never discussed nor alternatives weighed. It is hard to avoid the conclusion that the proposals, at their most daring, amount simply to the completion of the 1930s project which, apparently, constitutes the maximum of their ambition.

A crucial ingredient of this style of ‘discussion’ is that the *rhetoric* of reform is divorced from the *content* of the reform. Demographic changes are brought along to motivate the discussion but their role ends there: to justify the passage of the *same* package of measures irrespective of the size of the challenge. For example, in 2001/2 the UK Government Actuary Department’s (GAD) projections<sup>24</sup> of the demographic implications on pension expenditure were released, but were totally ignored afterwards; the measures proposed and implemented by the then government were not measured against the size of the challenge. Even more tellingly in 2007 the Government ordered new projections from the ILO, yet completed its own reform before it had even received them<sup>25</sup>. The 2007 government faced with the imminent retirement of the baby boom *failed* to promote the *same* reform package its predecessors in

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<sup>24</sup> These projections formed the basis of the 2002 EPC projections of expenditure to 2050 and are still in 2009 the most current measure of pension sustainability (Ministry of Employment 2001).

<sup>25</sup> Once received, and consistent with the model proposed in this paper, these projections were ignored and not discussed by anyone from either the government or the opposition.

the late '80s (faced with a far more benign demographic picture) had similarly failed to promote.

Each government in turn appears to work via a '*satisficing*' model (to borrow a term from Herbert Simon), where it proceeds along the given path as far as it can. It does as much as it can in the implicit knowledge that it will fall a long way short of where it needs to go. Overshooting the target is implicitly considered impossible, as reformers feel they are doing less than what is needed. We just struggle along, doing the best we can. The questions of whether the direction itself is appropriate or whether it needs adjusting are never posed.

If the analysis above is correct, even if by some miracle the full programme of pension reform as formulated –in the most daring dream of reform proponents– was implemented *immediately*, we would still be left with a pension system designed in the early 1930s on the basis of know-how that is three quarters of a century old. Would such a model be appropriate for 2050 and later on?

The question can be broken into two components:

- (a) Would the '*full-1930s system*' be viable? Though it would certainly be a vast improvement on current arrangements, the answer is probably that it would *not* be viable. Sample calculations by GAD (Ministry of Employment 2001, Tinios 2003) indicate that the sheer size of the parametric changes to equilibrate the current system defy belief. Even



so, rapid changes to the social contract could mean major gains in public finance, some gain in economic efficiency, but are likely to have a hugely negative knock-on effect on loss of credibility and erosion of trust to a system.

**(b)** Would the *'full-1930s system'* be appropriate? The 1930s model is exclusively a social insurance system, where rights-based benefits sit uncomfortably. Social welfare is not easily integrated into that structure, at a time when it acquires more significance. In the 1930s it was reasonable to assume that firms will be longer lived than individuals who could thus plan their careers around a single job, and that passive help for unemployed was sufficient. Very little attention was paid to gender issues. Finally, in the context of the 1930s there was very little alternative to a monolithic State provision. PAYG finance allocates all risk one-sidedly to the working generation and eschews any benefits of diversification.

Thus, should the question ever be put, a simple revamping of the traditional 1930s-style State is unlikely to be thought as an answer to 21<sup>st</sup> century concerns. Indeed, it is telling that in the majority of countries where pension reform was seriously discussed, some variant of a multi-pillar system was preferred. In the context of Greece, rebasing pension discussion would appear the best way to break out of the log-jam of syncopated ostrich-interventionism. Parametric pension reform fails because it creates many opponents and can mobilise few supporters. At best, what it can offer is the orderly management

of decline by instituting a process whose destination, however, is already devalued in the mind of contributors. Reform by instalments reneges on the social contract without offering a new one. Saying, for instance, that '*we have solved the pension problem for 15 years*' (as is wont of Ministers of Economy) is sure to alienate the majority of contributors who hope to draw benefits *after* that period. It imposes costs without apparently generating any benefits in the form of greater security (Featherstone and Tinios, 2006)<sup>26</sup>.

The need thus emerges for a fresh start. The *total distance* to be covered depends on 'objective' features of the way pensions are linked to the economy, and is ultimately independent of the number of instalments; there exists no 'magic bullet' that can secure adjustment without changes in individual behaviour. To present pension reform as a whole, rather than as a series of disconnected steps, would allow (future) gains to counterbalance (current) pain. An overall pension strategy could thus allay fears more convincingly and can plan to overcome the kinds of opposition that have stalled attempts to date.

What would a fresh start look like? Its beginning would be by rebasing pension discussion in order to win over younger contributors, who will be called to bear the brunt of the future adjustments. Such a discussion would need to centre around the allocation of risk, and to incorporate social security in such a way

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<sup>26</sup> The reactions to the Giannitsis' proposals in 2001 could be interpreted in this way. The apparent successes of the 2002 and 2008 'reforms' were due to their lack of ambition, as evidenced by the almost immediate call for new reforms. It is significant that now, Giannitsis (2007) accepts that 2001 was the last chance to implement parametric reforms and that conditions now necessitate more radical change.

as to help and not hinder economic development<sup>27</sup>. Barr and Diamond (2008) and Myles (2002) stress the importance of high growth and high productivity for the sustainability of social insurance. Both factors, as well as a Lewis-type dual growth caused by internal migration, were present in the formative years of social insurance in the 1950s and 1960s. Such conditions have ceased to hold, however, at least since the 1970s. Nevertheless, the current system is so dysfunctional in microeconomic terms, that its abandonment will have a positive impact effect. Apart from that negative observation, it is possible to speculate on the kind of features that a functional system to replace the antiquated 1930s model could have. Depending on priorities, one can envisage models that place greater emphasis on poverty prevention and others that focus more on income replacement, as well as shifting the monolithic emphasis on state provision.

One model that would appear to fit the bill and whose characteristics are well understood is the ‘Notional Defined Contribution’ (NDC) System first applied in Sweden but also introduced successfully in Italy (Holzmann and Palmer, 2006)<sup>28</sup>. In any case, the lessons of failure in Greece, and of success elsewhere, is that the key lies in careful preparation. This involves thinking through the characteristics of the reform and the administrative prerequisites; presenting the arguments for change is also critical. Otherwise, clinging to a familiar (if

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<sup>27</sup> Positive feedback loops between social insurance and industrial development were a key feature of the 1960s (Tinios 2003; 2008) at a time of rapid population and productivity growth. The challenge is to find new feedback loops today.

<sup>28</sup> Nektarios (2008) explores the implementation in Greece. Without altering the fundamental mathematics of PAYG social insurance the NDC system gives the impression of a fresh start. Costing of the proposal was undertaken by GAD (Ministry of Employment 2001).

moribund) 75-year system would once again be judged preferable to the alternative.

#### **4. In conclusion**

In 2009/10 a new reform episode is looming. Initial post-election complacency was succeeded by increasing stridency, as 'the markets' held the country in a vice. Is this Ostrich-interventionism with a vengeance, or can it be the final act of the tragedy?

In February 2010 it is too early to say. In the markets' attack on Greece, pension reform probably plays an important role. When one compares Greece with Italy, *both* countries have a bloated public sector, a huge National Debt and abysmal demographic prospects. Yet, only Greece (to date) is the object of attention. A possible explanation: Italy, having implemented a pension reform in 1996, can offer 'a story' of how demographic deterioration will be tackled. Greece, in contrast, has no such thing; politicians thought 2030 was too far away to worry. In previous bouts of pension reform (1992, 2002, even 2008) such a viewpoint was allowed to pass, largely because what was happening in Greece was thought of peripheral interest. In 2009, though, Greece was perceived as the Achilles' heel of the euro; the Greek National Debt became a test case of the stability of the Eurozone as a whole. Nervous bond markets focused on what was happening in Greece; their attention had the effect of telescoping future unease to the immediate present. If this reading is correct, to

let go they need to be told something to put their fears to rest. And that can only be pension reform. Taking up, once again, the analogy of the comic opera: Greek pensions were playing in provincial theatres in front of indulgent audiences, many of whom were directly related to the cast<sup>29</sup>. The provincial troupe was suddenly catapulted centre stage at the Milan Scala, attempting to satisfy discerning and sceptical critics.

So, a ‘pension reform’ we will certainly have in 2010. Will it galvanise the opposition to all adjustment, as it did in 2001, or will the sense of national crisis prevail on citizens to pull together? Those general questions will depend a good deal on the characteristics of that reform: Will that pension reform be worthy of the name, or will the need for haste promote something that will only have to be undone later?

Either scenario is feasible. What is certain is that Greeks are finally waking up to the wisdom of *‘If we want things to stay as they are, things will have to change’* (Giuseppe di Lampedusa *The Leopard*, 1957).

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<sup>29</sup> The benefits of being in the periphery were evident in the cases of the two stabilisation loans received by Greece in 1985 (from the IMF) and 1990 (from the EU). In both cases Greece claimed only the first instalment, largely because it had not fulfilled the conditions for receiving the second one.

## **Appendix I. The last Instalment: A Strategic Framework for Pension Reform**

This writer, in a proposal presented in autumn 2009 (Tinios 2009), argued that to break out of the cycle of syncopated reforms it is essential to aim at a definitive system fixed for a generation<sup>30</sup>. Since then, the public finance crisis created a sense of urgency, possibly even panic, but also conflated short-term features with long-term issues. A pension reform, whilst addressing immediate concerns, should aim to secure for itself the serenity to ponder solutions that will still be there 40-50 years on. Such changes cannot be prepared overnight nor can they be accepted and digested without a period of reflection<sup>31</sup>.

If the analysis of this paper is correct, the chief problems that the well-intentioned reformer will face in 2010 are the lack of preparation, the non-existence of administrative prerequisites and the dearth of implementable ideas. Policy thus faces a critical dilemma: proceed with reforms with are insufficiently prepared and risk being overturned, *or* miss a unique opportunity for meaningful reform? The answer to the dilemma is to realize that reform does *not* necessarily have to be legislated in one go in 2010. What is essential is to announce a phased programme, which after a given period of gestation, leads to a *definitive* ‘last instalment’ embodying a fresh start. To put in place a convincing reform package, it would be sufficient to pursue a strategy in two and a half phases:

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<sup>30</sup> A more detailed analysis on those lines is under preparation to appear in book form in early 2010.

<sup>31</sup> A further problem is that a good many measures may have a negative impact effect (which is later reversed). That is no reason, however, for not implementing them.

(a) The **Immediate phase** would involve corrective measures with immediate public finance impact and would show determination to solve the problem as a whole, and not ‘as much as we can bear’. Such measures could be sought among parametric proposals which meet no serious objections. Such would be a consolidation of the Civil Service arrangements, measures for the Seamen’s Fund NAT, consolidation on the revenue side, implementation of the Heavy & Hazardous Occupations proposals, capping pensions at 100% of final salary and possibly other measures. Of vital importance would be the arrangements for studying and proposing the definitive phase<sup>32</sup>, whose function would be to signal that the matter is not being left to its fate.

(b) **The Definitive phase** cannot come before 2-3 years’ time, when the “Last Instalment” would be legislated. This legislation should offer a full blueprint for the long term, a detailed description of the adjustment period and an Action Plan for implementation of accompanying administrative actions and ensuring the existence of smooth operation of the required logistical infrastructure. The new arrangements must be designed (as was IKA originally) to last for 2 generations at least – i.e. to carry the system well into the 2050s.

(c) **The Interim phase.** The period intervening between the two bouts of legislation (the ½ phase) must be devoted to an intensive study of needs to be met and means to meet them. Though it is true to say that there exists no ‘magic bullet’, in the sense that people will have to revise their expectations

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<sup>32</sup> To this effect, temporary measures may be implemented – such as a temporary levy on pensions – to be rescinded once the definitive phase is legislated. In that way, there would be something to gain by the conclusion of discussions.

and plans, the feeling of many experts is that NDC will probably form a good part of the ultimate answer. However, that remains to be proven, which can only be done if all alternatives are studied, costed and their pros and cons aired and discussed.



## Appendix II. A brief chronology of Social security in Greece

Period	Landmarks	Key characteristic
Inter war Period	League of Nations Committee proposes version of Czech system Law 5733/ 1932 leads to fall of <i>two</i> Gov'ts (E.Venizelos an A.Papanastasiou). <b>1934</b> Popular Party passes law 6298 «On Social Insurance», after compromise. <b>1937</b> implementation of Law by the Metaxas Dictatorship. IKA begins operations December 1937	Formulation of the “IKA vision” the model of development for social protection in Greece. Based on (a) IKA as pole of attraction and (b) gradual absorption of preexisting funds.
1950s	IKA restarted by Law 1846/51 Compulsory deposits of fund surpluses in the bank of Greece ( Law 1611/50). First reports outlining need for reform.	Gradual implementation and spread of the postwar model <i>Implementation of decisions taken in the 1930s</i>
1960s	1962 Farmers' Fund (OGA) set up. 1964 Decision not to levy contributions in OGA 1966 Public Power Corporation disaffiliates from IKA 1969 L. Patras reform in the dictatorship collapses	Start of revisions to and departures from IKA vision. First intimations of difficulties of reforms.
1970s	1972/3- The system faces the challenges of inflation. Pensions' erosion. Emphasis on social role of minimum pension. Expansion at the intensive margin (setting up of auxiliary fund ETEAM L 997/79).	Search for a social role of the social insurance system. Ad hoc solutions tamper with central philosophy of social insurance. Overall reform forgotten.
1980s	Acceleration of rises in minimum pensions Large deficits in Funds from 1980 National Health Service changes role of social insurance and transfers health deficits to the State budget.	Search for structural changes to correct current deficits. ‘Social Insurance impasses’ and reform difficulties
1990s	Emergency measures 1990/2, motivated by public finance. N2084/92 «offers new lease to the system» Permanent changes pre-announced for the future. 1996 EKAS is the first means tested benefit. 1997 Spraos Report shocks public opinion	« <i>Solution of pension problem</i> » becomes a permanent issue in political economy. Beginning of awareness of demographic deterioration. Old age poverty becomes concern
2000s	(a) 2001/2 PASOK attempt: GAD projections/ Giannitsis Debacle/ Reppas Law 3029 (2002) announces future measures (b) 2006 Derivatives scandal leads to 2007/8 ND attempt: ILO Projections ordered/ Law 3665 Deals with administrative issues. (c) ?????	‘Reform by Instalments entrenched’  “Ostrich-interventionism”  EMU entry ‘europeanises’ problem.

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