

## MISPERCEPTIONS, MISSTATEMENTS, MISUNDERSTANDINGS

### Technical clarifications on Greek pensions

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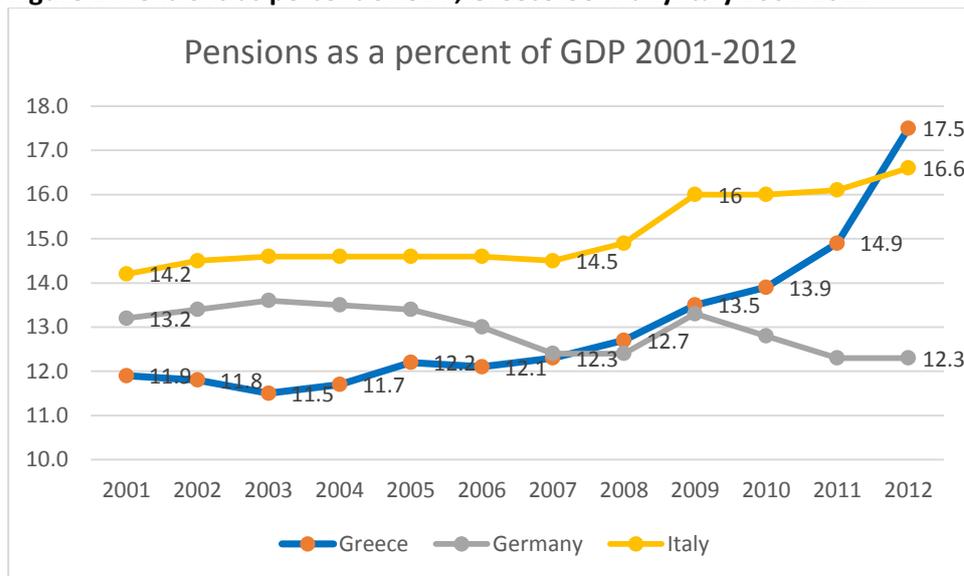
# Misperceptions

## Greek Pensions are low due to the recession

Pensions *rose* and are now the *highest* in the EU. Pensions as a percent of GDP continued rising through the crisis. In the last available EU comparable data, 2012, Greece spends the largest proportion of any EU country, including the two countries with worse demographic prospects, Germany and Italy (Figure 1).

1. *Before* the bailout, total pensions kept up with the rapid growth of GDP up to 2007. They rose after 2008, as *both pensions per head rising, and* the number of pensioners increased.
2. *During* the bailout, there is an explosion of expenditure. The pension bill is the largest, relative to GDP in the EU, (the next highest is Italy). Though the 2013 cuts have (reportedly) cut that back to 16.2 %, that would still remain at the extreme end of the EU. There are no more recent data.
- 3.

**Figure 1: Pensions as percent of GDP, Greece Germany Italy 2001-2012**



Source: Eurostat (accessed 12/2015)

Pensions as a percent of GDP are high because the *denominator* is low. We should not use GDP.

Pensions not only climbed as a percent of GDP, but also rose in absolute euro amounts. This happened because: (a) The *number of pensioners* rose, as there was a wave of early retirements. (b) Pensions *per head* are higher (at least before cuts), as recent pensioners have higher average incomes than older ones. (c) Falling prices have also meant that real value of pensions is increasing.

However, it is true **that GDP fell**. Per head of population, in 2014 it is lower by a quarter, 26.3%, than what it was in 2008. This is no reason to disregard it. GDP measures productive capacity; it is also a rough guide to average incomes. Both these are lower, and they are

permanently lower. Disregarding lower GDP could be justified by three assumptions, all preposterous:

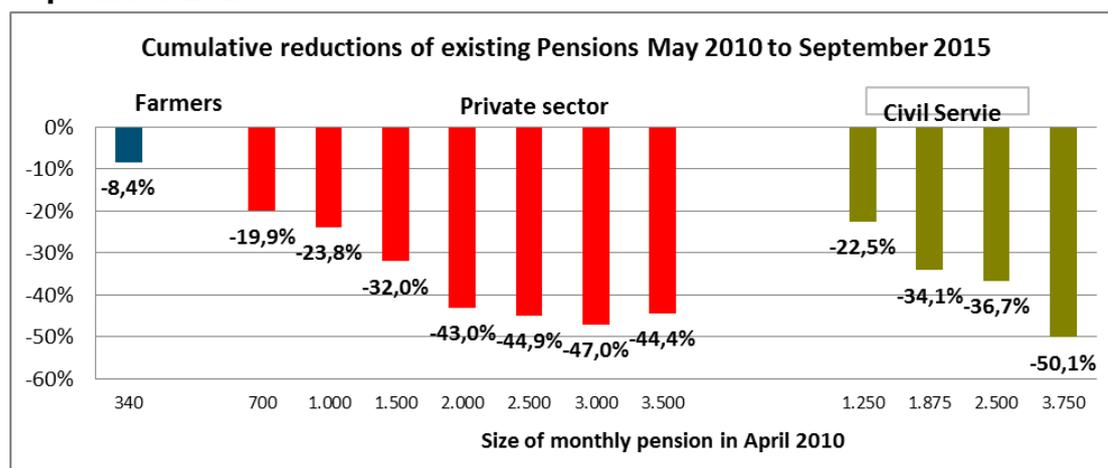
- Assuming that the crisis never happened, *or*
- Assuming that it will be corrected automatically, *or*
- Assuming that some groups, such as pensioners, are entitled to be exempt. If one group is exempted, someone else has to pay more.

Pensions have been cut by 40%.

**It is true** that pensions-in-payment, that is pensions of all pensioners, including people in the nineties who had been collecting their pension for twenty years or more, had their pensions cut at least ten times since 2010.

This, in itself, is unprecedented and in a number of countries has been ruled unconstitutional (Romania, Latvia, Portugal partly). It is also true that a private insurance company would probably have to go bankrupt before unilaterally cutting annuity payments. It is certainly a blow to the implicit social contract underlying state pensions: Why should a grandchild pay contributions, if she sees her grandfather's pension cut?

**Figure 2: Cumulative falls of different kinds of pensions, May 2010-September 2015**



**Source:** Tinios, 2013, updated for 2014 cuts in auxiliary pensions and 2015 increase of pensioners health contributions. Impact may differ according to the type of auxiliary pensions and their share of the total. Sums are annualised to take into account the abolition of holiday bonuses.

However, a great deal of confusion has been deliberately cultivated. What follows tries to put the record straight:

- **Why?** Pensions were cut because no other source of finance was feasible. No one was lending, while structural measures take too long to work. That being said, cutting pensions is easier than wages; pensioners cannot strike.
- **How?** On a number of occasions, usually when there were unexpected increases in public deficits, due to higher expenditure or lower revenue. Cuts were always a panic measure, blamed on the crisis and declared to be temporary. They were never presented as linked or due to pension issues.
- **Who was affected?** Each cut was considered independently and ignored the previous cuts. Thus the *same* person's pension was cut again and again, producing large cumulative reductions. Effectively the only criterion used was the size of pension; this,

among other effects, rewards those who have evaded contributions and severs the (anyway weak) link between contributions and pensions. New pensions are calculated under 2009 entitlements and then subjected to the cuts one by one.

- **By how much?** As size of pension was the only criterion, some large pensions have been cut (in total) by over 40 per cent. Given that property taxes and income taxes have also increased, these people might find themselves having lost 60 per cent or more of their income. (figure 2)
- **BUT** those affected by the high figures are a small minority. (Table 1)
  - **45%** of pensioners (pensions <€700) have only lost the holiday bonuses (14% annual cut, or less).
  - **65%** of pensioners (pensions <€1000) have lost less than the fall in GDP per head.
  - **87%** of pensioners (pensions <€1500) have lost less than the fall in average earnings (30%).
  - **Those whose pensions were cut by 40%** are around 2 per cent of the pensioner population, 48 thousand out of 2.6 million people.

**Table 1. Distribution of pensioners by total pension size , May 2015**

In thousands €	Population in each bracket Thousands€ (000€) %		Cumulative distribution « <i>Poorer than...</i> »		Cumulative distribution « <i>Richer than...</i> »	
			Number 000s	Per cent	Number 000s	Per cent
> 3 €	2.5	0.1%	2654.5	100.0%	2.5	0.1%
2-3 . €	47.9	1.8%	2652.0	99.9%	47.9	1.9%
1.5-2 . €	308.6	11.6%	2604.1	98.1%	308.6	13.5%
1.0-1.5 . €	552.5	20.8%	2295.5	86.5%	552.5	34.3%
0.7-1.0 . €	558.4	21.0%	1742.9	65.7%	558.4	55.4%
0.7-0.4 . €	828.3	31.2%	1184.6	44.6%	828.3	86.6%
< 0.4 . €	356.3	0.0%	356.3	13.4%	356.3	100.0%
<b>TOTAL</b>	2654.5		2654.5		2654.5	

Source: Helios database, May 2015

### Why is there such persistent misinformation about pension cuts?

The claim that ‘Pensions have been cut by 40 per cent’ has been repeatedly made by the Prime Minister, the Minister of Finance, all the way down to regular press briefings. It threatens to be regarded as a truism. We saw that *some*, about two per cent, one in fifty, pensions have, *indeed*, been cut by 40 per cent. The vast majority of pensions, however, have been cut by less than working incomes. Why the misinformation?

- Strategic desire to shield pensions more than other social programs. Delays in implementing Guaranteed Minimum Income have been blamed on a lack of funds.
- Using pensioners as shields to protect others who are well-connected.
- The social networks of SYRIZA ministers are amongst those with large pension cuts<sup>1</sup>.

<sup>1</sup> Some SYRIZA ministers are themselves pensioners of ‘privileged’ providers, such as banks or telecommunications. Behavioural Economics cites the “Law of Small Numbers”, whereby immediate personal observations outweigh statistical generalisations. (Of the sort: “I have heard smoking is bad, but my grandfather smoked and he is ninety and healthy”).

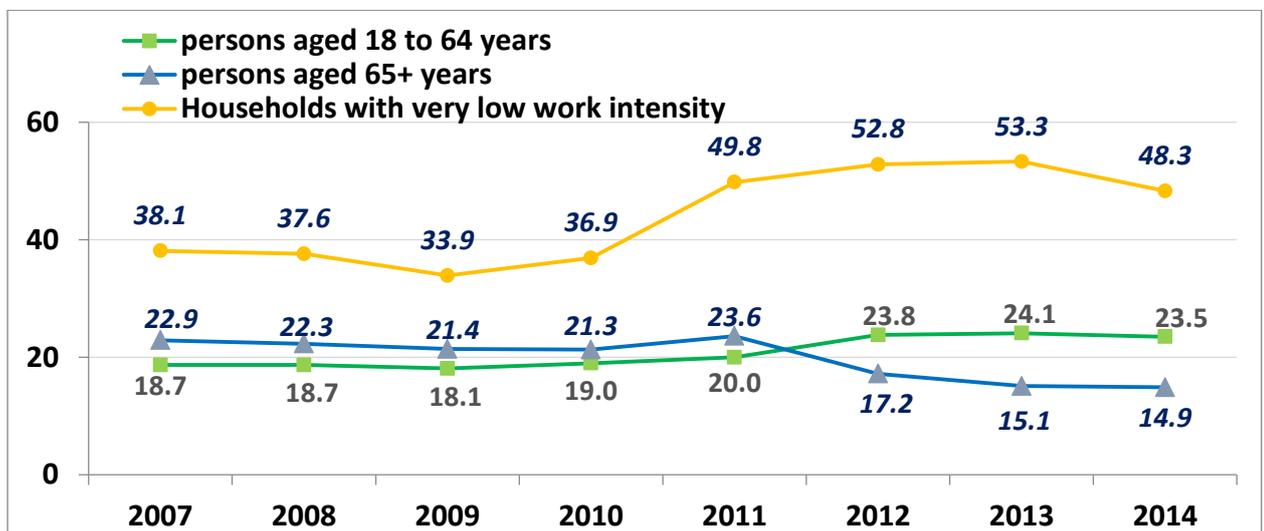
- The pension cuts are highest for public enterprises, where pay cuts have been more restrained; the fall in *expected* replacement rates would be highest there.

## Misstatements

Pensioner poverty has increased dramatically.

Given the above, it should come as no surprise to find out that **old age poverty has fallen considerably** during the bailout (Figure 3). The at-risk-of-poverty rate for the over 65s was 23.6% in 2011. By 2014 it had fallen to 14.9%, down by 8.7 points, or by more than a third (36 per cent).

**Figure 3: At-risk-of-poverty rate in Greece, for specific groups, 2007-2014**



Source: Eurostat. Definitions of concepts are to be found in Box B1.

**Why?** Poverty as usually measured is *relative* poverty. It results by comparing each poor person with a yardstick equal to the income of the *middle* individual in the income distribution (the median). The median in the case of Greece corresponds to a private sector worker whose family income has fallen far more than low pensions. The poverty threshold for one person fell from 6.9 thousand euros in 2009 to 4.6 thousand in 2014 – more than low pensions. As a result we see a fall in pensioner poverty and a *rise* in households with little access to employment – chiefly the unemployed.

**Other concepts of poverty** show a rise. For instance, if we compare incomes to the poverty line as it was in 2008, before the crisis, then the rise for the over 65s is from 22.3% to 46% per cent. However, the rise is even larger for other groups; so, the conclusion that the old are relatively less affected *remains*. Similarly, other concepts of poverty which introduce absolute notions to poverty (e.g. Material deprivation, social exclusion) show a deterioration, which is connected to the overall fall in living standards.

**So: the country as a whole is poorer. In this context other groups have been hit more than pensioners, despite loud protestations to the contrary.**

## Pension contributions in Greece are low.

Social Insurance contributions were relatively low as a percent of GDP in international comparisons. This is because large groups of the population pay contributions which do *not* depend on their earnings – farmers, the self-employed. They instead pay a head tax, regardless of earnings, paying even when their turnover is zero or (in the case of the free professions) even when they are unemployed. The other side of that coin is that well-established professionals and businesspeople pay little (as a proportion of their incomes).

In contrast, contributions of employees are very high. They are higher than they seem, as one has to add different contribution rates – for primary pensions, auxiliary pensions, separation payments, health, unemployment etc. These, for those cases where it makes a difference for competitiveness (e.g. export sectors), can rise above 50%. To work out the full bill, one has to factor in the cost of tax-financed budget grants, which adds another third on top of that.

The noise currently created by imposing existing proportional contributions to the self-employed (as is the case in the current reform proposals) should help underline how high *others'* contributions are.

## The pension problem is due to the write down of assets (PSI) in 2012

A frequent accusation is that 'there would have been no problem now, had assets of pension funds not been subjected to a write-down as part of the PSI in 2012'. That was presumed to have cut €14 billion off reserves (though that is probably inflated, as it compares losses to peak prices). However it may be, there is a misunderstanding at work:

- a. Even 14 billion would be a one-off injection which cannot solve a continuing problem. At best it would have postponed the same problem by 1-2 years.
- b. These reserves belonged to specific privileged funds representing a tiny fraction of the population. Their restitution would have made the situation of (say) lawyers better, but would have done nothing to solve the entire problem.
- c. The state system in Greece is not based on prefunding, but is Pay-as-you-go, which uses today's contributions to pay for today's pensions. In such systems, reserves are only used to smooth year-to-year fluctuations in contributions; Germany is a case in point. Indeed, those Greek providers who had reserves, never used them to pay pensions; the engineers' funds used them to buy a bank.

## There would have been no pension problem if there was no crisis.

The pension problem preexisted and is ultimately due to ageing, definitely *not* due to the crisis. Similarly, for unemployment. The need to reform pensions, as well as the existence of large pension-linked deficits, were a feature of the Greek landscape since the 1980s, when unemployment was still below 10 per cent. Unemployment in Greece, moreover, has always been more a matter of inability to enter employment on the part of young people or mothers, rather than sackings or redundancies.

## Misunderstandings

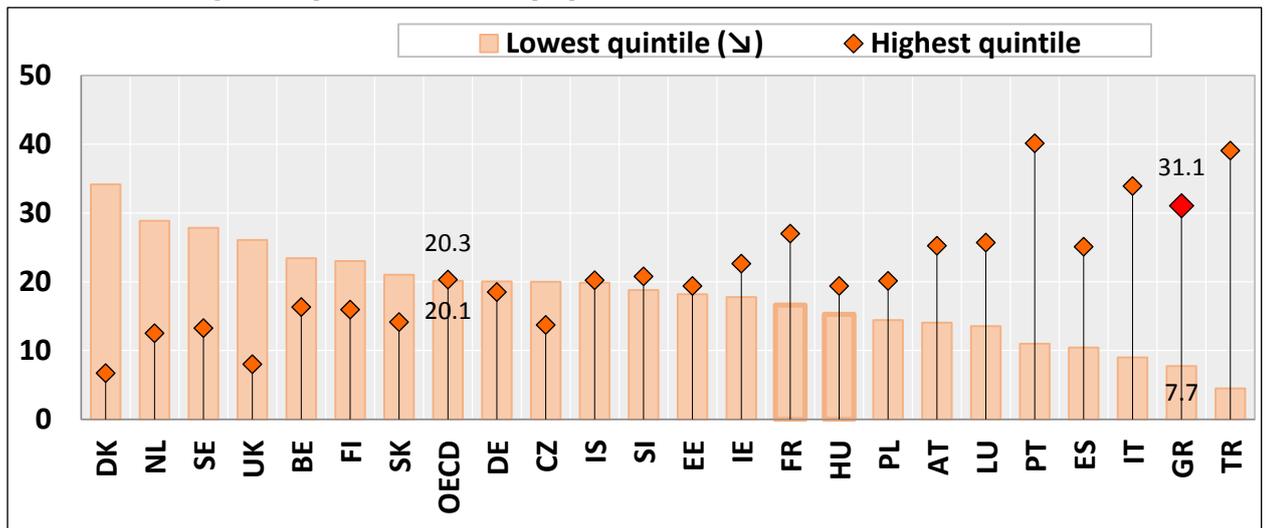
### Greek governments care for the poor.

Governments, and perhaps especially left wing ones, may do so *in general*. However in Greece government seem to be concerned to retain the *status quo*. This status quo is very unequal. Figure 4 shows the percentage of total social benefits paid to the richest 20% and to the poorest 20% of the population. In the OECD as a whole, the system is more or less proportional – each gets about its share of the population. In Denmark, the poor get over 30% and the rich less than 10%. In Greece, it is the *reverse*: The richest get 31.1% and the poorest 7.7% - the rich four times more than the poor. So social expenditure makes income inequality *worse*: it gives to those who already have, what is known as the “Matthew Effect”, after the evangelist (‘To those that hath, shall be given’.).

**Why is social expenditure in favour of the rich?** Two reasons: (a) Virtually no social benefits are given with an income test – the same amount, e.g. in child benefit, is given to rich and to poor alike. (b) As the pension system is fragmented, the rich are overrepresented in the more generous parts of it. That is a result of political deals and cronyism – what political scientists call the clientelistic system.

Correcting this in order to produce a more egalitarian system would hurt clients of the political class. So, governments of all hues – right and left - have steered clear of changing social policy structures in a more egalitarian direction. SYRIZA is the latest example; it is resisting pressure to start a general Guaranteed Minimum Income, whilst protecting pensions.

**Figure 4: Percentage of public social benefits in cash paid to the lowest and highest quintiles, total population, 2011**



Source: Adapted from OECD (2014), "Social Expenditure Update - Social spending is falling in some countries, but in many others it remains at historically high levels", figure 5, page 5.

### Pensions of the 2010 new system affecting the young generation are low.

They are low compared to those of the ‘old’ system, that is, for people who started work before 1993. However, that is not the right comparison. People who will retire after 2030 or

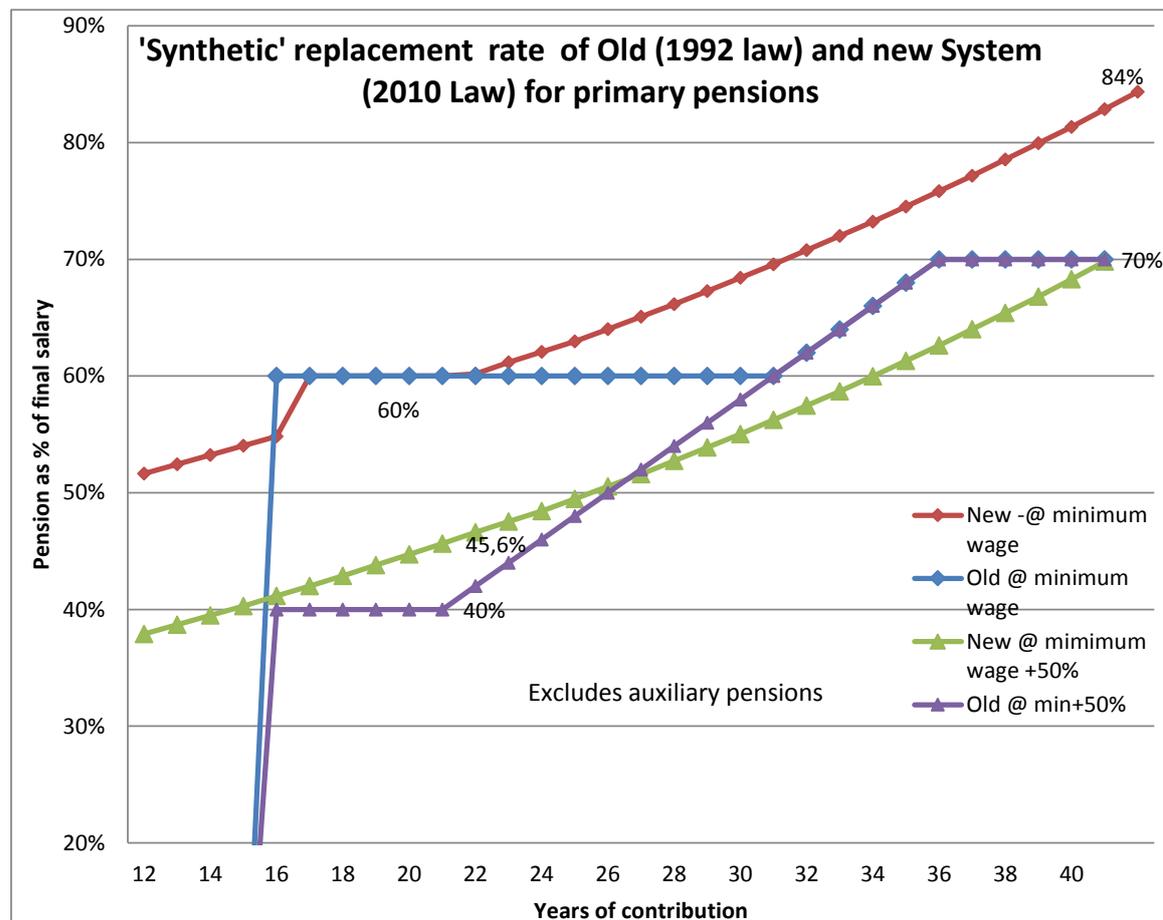
so, would have been entitled to the system introduced in 1992 for new entrants. The correct comparison, therefore is between the 'new system of Law 2084/92' and that of the 'new system of Law 3863/10'. (Figure 5) This comparison is, in some sense artificial, as it compares two theoretical systems, neither of which has been tried in practice, as no old age pensions have been issued for either one or the other system.

The key feature of the post-2010 new entrants system is the new flat rate-basic pension, which, at low incomes leads to much higher generosity. After that, the fact that the 'old' system has a higher accrual rate (2% per year), only yields higher pensions for high income individuals and for many years of contributions. If we take as given a long contribution record, and factor in that auxiliary pensions (and possibly separation payments) will be paid over and above that, it is not difficult to reach replacement rates close to or even above 100%.

Thus, post 2010 'new system pensions' are *not* particularly low by European standards.

If we compare the 2016 proposals with the 2010 new systems, the two are almost identical. The charge that 'the new system destroys incentives' applies to both

Figure 5: Simulation of Replacement rates of the old and new pension systems, for different career lengths

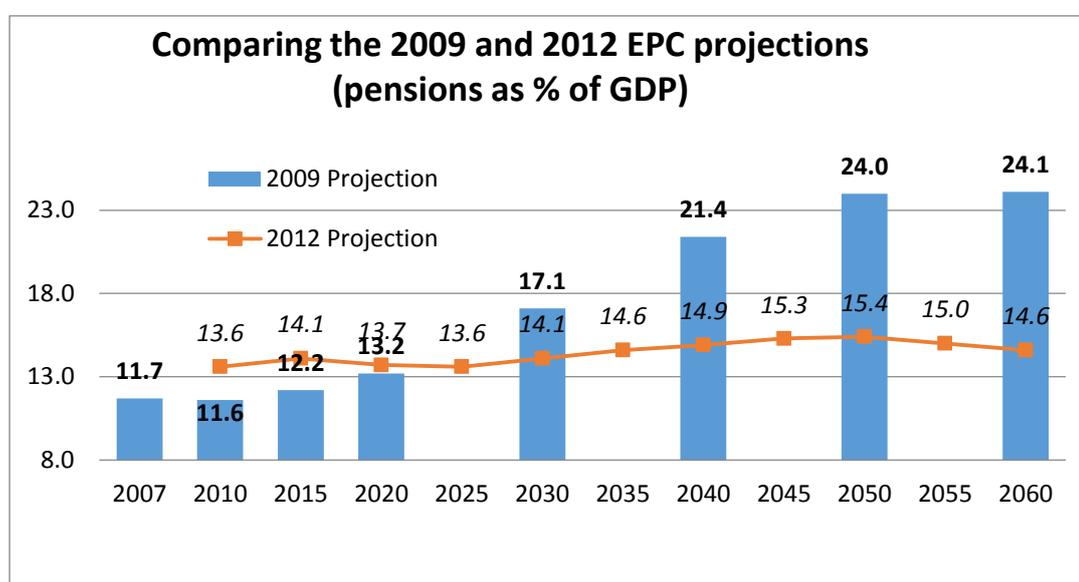


Source: Tinios 2013, Appendix 2. Auxiliary pensions are not included. Pensions are evaluated at different years of contributions for individuals paid through their lives at (a) the minimum wage; (b) minimum plus 50%

## In what sense are pensions ‘viable’? – long-term and short-term

The sense of ‘viability’ used in viability pronouncements typically referred *only* to the very *long* long-term – *the expected increase in pensions as % of GDP in 2060*. The IMF ex-post review concedes that the reform, despite addressing pension sustainability, ‘addressed only long-term structural imbalances’. We can see this by comparing the official expenditure projections submitted to the EU Ageing Working Group (AWG) in 2009 (before the reform) with those submitted in late 2010 (published in 2012) which incorporate the effects of the reform. Figure 6 compares the two projections to show that the effect of the law only begins to be noticeable well after 2020. That was on the basis of (optimistic) expectations of 2011. However, the point remains that viability *never* referred to the short and medium-term, *ie to the period before 2030*.

Figure 6: Comparing official pre- and post-reform projections, 2009 and 2012



Source: Tinios 2013, appendix 1, using EPC Ageing Working Group projections

## How is viability attained in the long term?

2060 is affected by the full application of the ‘new 2010’ system – what economists call the ‘steady state’. Viability to 2060 depends on *three* factors:

1. Basing income replacement on **career income**, rather than a five year average as previously. This is indexed by an index of wages, rather than prices. (see on)
2. Drastic increases of **retirement ages** which for the age groups affected had already been raised to 67; this is due to increase further by the requirement of further rises, depending on regular 10-year reviews of life expectancy should take place, starting in 2020.
3. **Replacement rates**. These for full 40-year careers *remain* at 80 per cent, which is at the top range of EU State pensions; on this should be added auxiliary pensions. So, this will only reduce pensions for careers equal to today’s average career – around 25 years as opposed to 40 years which would be considered reasonable for the EU. (For people retiring at 67, 25 years would imply unemployment rates in excess of 50% sustained for 30 years, or a continuation of rampant evasion.

## Are these long term reductions in pensions believable?

Retirement ages will undoubtedly work as planned. Replacement rates will probably be greater than now- people will draw higher pensions for shorter times. The shift to career incomes will only give savings if incomes grow smoothly throughout everyone's lives – so that pay when young is much lower than pay when at retirement- i.e. if the world is like the Civil Service. Manual workers have age-earnings profiles which peak at 40, while insecurity of employment will mean that averages will be affected by the incidence of unemployment. On balance to expect major savings from this would be very optimistic.

## The system affecting the young generation is fragmented.

Fragmentation was a design feature of pensions in Greece and was, in effect, the reason for their downfall. However, the situation for the new system of the 2010 Law is radically different. Everyone is entitled to a pension at 67, and is forced to contribute to two layers of State-run pensions. These two layers result in replacement rates which, by European standards, are very high. With a forty-year career, which is no exaggeration given that we are assessing a situation 35 years in the future, pensions are between 80 and 90 per cent of career incomes. This compares very generously with other European systems, in which the compulsory State-run part has been pruned back to c40% replacement rate, partly to make way for other type of pensions. In this context, defined benefit pensions pose greater problems for future production: Like debt servicing obligations, they specify a particular share of future output *in advance*. In contrast, defined contribution pensions, can be thought as a kind of partnership to share risks between, on the one hand, future pensioners and, on the other hand, future producers.

**Whichever way one sees it, the future problem of Greek pensions is not fragmentation, any longer, but its opposite: lack of flexibility and overinsurance.**

## FURTHER READING

Good and authoritative sources of information with access to sources that have not been released are the IMF's special page, "The IMF and Greece" <http://www.imf.org/external/country/GRC/>.

The biennial OECD *Economic Surveys: Greece*;, Paris are perceptive and authoritative. Reports exist for 2009, 2011, 2013. 2015 should be available soon.

The author of this note has written a book (in Greek) on deciphering the pension system, with extensive analysis of statistics:

Π.Τήνιος, 2010, *Ασφαλιστικό: Μια μέθοδος ανάγνωσης*, (The pension problem: A method to decipher) , Κριτική.

An easily available review of the link between reforms and the last stage of the crisis, containing extensive statistical information is a report for the European Parliament:

Platon Tinios, 2015, Employment and social developments in Greece, DG for Internal Policies, European Parliament, October 2015. [http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563468/IPOL\\_STU\(2015\)563468\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563468/IPOL_STU(2015)563468_EN.pdf)

A description and a more optimistic view of reforms 2010-2014,

G.Simeonidis, The Greek Pensions Reform 2010-2014: A leap forward, March 2015 <http://www.actuaries.org/oslo2015/papers/PBSS-Simeonidis.pdf>

On poverty, of interest is:

Manos Matsaganis and Chrysa Leventi, 2014, Poverty and Inequality during the Great Recession in Greece, *Political Studies Review*, Volume 12, Issue 2, pages 209–223, May 2014

The Confederation of Trade Unions Observatory of the Institute of Labour (INE-ΓΣΕΕ) publish studies and statistics (in Greek only) <http://ineobservatory.gr/>.