Pension Reform in Greece: A Discussion

by
Noriyuki Takayama

(to be published in Holzmann, R., Palmer, E. and Robalino, D. eds., *NDC Pension Schemes: Progress and Frontiers in a Changing Pension World*, World Bank, 2012)

Political Risk

The pension system of Greece was a typical example of the Mediterranean welfare state with extensive segmentation, concomitant contribution evasion, and a very low labor-force participation rate. The system also had a number of serious problems in regard to equity, as well as long-term financial sustainability. Moreover, Greece has missed many opportunities to reform its pension system over the last thirty years. This inaction was due largely to a lack of political consensus.

The basic feature of recent pension reforms in developed countries has been to provide a specific solution to the problem of sharing an increasing cost of pensions among different groups and setting a limit for what is acceptable. This is the point at which many countries have turned to NDC. Whatever the solution adopted, there will inevitably be winners and losers. Usually it is very difficult for losers to accept any disadvantages arising from the pension reform proposed by policy makers. The painstaking process of pension reform may thereby be delayed or even rejected. Strong leadership is required to deal with this kind of political risk.

Another driving force for pension reform has been growing pressure from outside. The 2010 pension reform of Greece is an example of this. Greece's sovereign debt got out of hand and the Greeks were forced to adopt a hasty and drastic reform that substantially reduced promised pension benefits in order to secure their long-term borrowing requirements on the international financial market. The most significant measure mandated in 2010 was to abolish all special provisions for early retirement before age 60, while raising the standard pensionable age to 65. People in Greece were subjected to a sudden disruption of their economic/financial life planning without being given enough time or appropriate means to adjust to the new situation, as the author of this chapter explains.

Since the Greeks needed a pension system under financial control, the reform imposed in 2010 was necessary. However, it was not sufficient, but only Step One in the reform process. Greece still does not seem to have given clear thought to the basic structure of a pension system that would be equitable, adequate, and financially sustainable. Generally speaking, a national pension system should have four basic pillars, including NDC as a core component. Greece is no exception, as the author of this chapter demonstrates. Greece needs to move on to Step Two of the reform process by introducing the NDC and FDC financial pillars.

One difficulty with this shift to a new paradigm is that the transfer from general revenue would increase in the short run if the contribution rate for the main system were reduced from 20% to 16%, in accordance with the proposal suggested by the author of this chapter. Another difficulty could arise from the possibility that potential losers under the paradigm shift might persistently oppose Step Two.

If we adopted a broader perspective and allowed Greece to opt out of the Euro currency zone, then the country could alter its exchange rate and follow more decisive fiscal policies. As a consequence, the fiscal strain could be reduced and the Greeks might have more time to implement the Step Two reform. This in itself can be viewed as a potential lesson from Greece.

The plight of Greece viewed from the Japanese perspective

Politicians in Japan have also been reluctant to propose painstaking pension reform. In 2004, however, they succeeded in making the paradigm shift virtually to NDC by fixing the contribution rate of the principal pension system at 18.3% from 2017 on. At the same time, they introduced an automatic balance mechanism that was free from political risk. It is a new formula for indexation of pension benefits that takes demographic factors into account[1].

Japan still has many challenges in pension management. The principal ones are as follows.

---

[1] See Takayama, N., "Changes in the Pension System," *Japan Echo*, October 2004, pp. 9-12.

1. The automatic balance mechanism has not yet been activated, since it was designed in its legislation not to apply during deflation, from which Japan has been suffering for more than ten years. The new indexation formula, by contrast, must be followed irrespective of inflation or deflation.

2. The proportion of atypical employees has been increasing, reaching 40% in 2010. A growing number of young employees are forced to enter the job market as irregulars and are given few opportunities thereafter to be upgraded to regular status, with higher and more stable salary. In addition, Japan is seriously affected by the "Bad Start, Bad Finish" problem, noted by Italian and other experts (cf. Gronchi and Nestico 2006, Franco and Sartor 2006, Boeri and Galasso 2012, and Chłoń- Domińczak et al. 2012)[2].

3. The normal pensionable age is still 65 in Japan. Its automatic indexation to longevity is essential to the long-term financial sustainability of the pension system.

4. Current provisions for full-time housewives[3] are under severe attack from dual-income couples and single women. An income split between an income-earning husband and his dependent wife could be a solution to this problem.

5. Employees working less than thirty hours a week are currently not covered by the pension program with the earnings-related component. The issue of extending the coverage to employees working at least twenty hours a week is currently under heated discussion in Japan.

As any new measures like those mentioned above involve winners and losers, Japan will be taking a political risk if it seeks to implement another pension reform in the near future. In this sense, Japan has put itself much into the same position as Greece. The answer is to take a more definitive step forward under political consensus. Whether Japan is capable of doing this remains to be seen.

---

[2] See Galasso, V. and Boeri, T., "Is Social Security Secure with NDC?" in Holzmann, R., Palmer, E. and Robalino, D. eds., *NDC Pension Schemes: Progress and Frontiers in a Changing Pension World*, World Bank, 2012, Chapter 15, for example.

[3] See Takayama, N., "Pension Coverage in Japan," in Holzmann, R., Robalino, D.A. and Takayama, N. eds., *Closing the Coverage Gap: the Role of Social Pensions and Other Retirement Income Transfers*, Washington DC: the World Bank, 2009, pp.111-118.