A pension system for younger workers in Greece: A proposal for growth

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Recent pension reforms help to trap Greece in deep crisis, but only increase the insecurity of pensioners. To break out of that vicious circle, a fresh start is needed. Such can result from the immediate introduction of a new type of pre-funded pensions. Such a new system, will put a stop to the reneging on pension commitments and can give a decisive impetus to the growth process. A detailed proposal was presented in December 2016 by a team of three academics from the University of Piraeus. That proposal has been quantified, potential problems identified and solutions proffered; even the considerable transition problems are likely to be more tractable than the most probable future course of the present, totally non-viable, arrangements.

The current system imposes record costs on the economy: Pensions expenditure at 19 per cent of GDP and contribution rates at 27 per cent are the highest in the EU. Such a burden to the economy, nurtures uncertainty for pensioners and undermines competitiveness. Despite the excessive contribution rates, financing of that system requires 40 per cent of all tax revenue in government transfers, while the 'hidden debt' of state pensions for the period to 2060 will rise to 470 billion euros (discounted at 2 per cent) – larger than the National Debt. Extensive subsidies from the general taxpayer are set to become a permanent fixture, going deep into the future. So, even after the 2016 reform, the Greek pension system remains too statist, too costly, too restrictive and too inflexible. It poisons Greece's economic future and encourages emigration of young qualified people.

Our proposal serves two objectives: Firstly, it accords top priority to the immediate start of a new pension system based on full reciprocity for all those who started working after 1992 – that is for virtually everyone under 45 years of age. A major reduction in contribution rates is combined with the immediate introduction of a new, prefunded, pension pillar. Secondly, for the older system participants (who started working before 1993) it aims for the largest possible reassurance – that is for a durable guarantee that pensions will not be cut again – for at least the next 20 years.

More specifically:

I. A new pension system for younger Generations – those first insured after 1.1.1993: A three-pillar system can lead to an expected total replacement of around 75%.

A. First pillar: A single provider for all primary pensions (EFKA)

- Contribution rate 10% (down from 20% today).
- Pensions result on a Notional Defined Contribution basis ('Swedish system') financed on Pay-as-you-go principles. Contributions are credited to personal accounts and cumulate with a technical interest rate related to the rate of growth of GDP adjusted for demography.
- The pension age is decided by the insured persons themselves, starting from 65. A decision to remain in employment will lead to a fully compensatory pension increase.

B. Second Pillar: New mandatory Prefunded Supplementary Pension System.

- Contributions at 6% (as currently directed to PAYG auxiliary funds)
- Credited to a personal account, where pension capital accumulates.
- Pensions will be financed by the build-up of reserves, which are expected to rise to EUR 50 billion in the first ten years and to EUR 600 billion by 2060 (around 80% of GDP). Reserves are utilised to create a new National Fund for Investment.
- To increase the sense of ownership of accounts, opting out is allowed.

C. Third Pillar: Voluntary Occupational Pension Funds

- Occupational funds allow for flexibility across employment sectors.
- The existing separation funds are transformed into Occupational funds. Their current property is added to their reserves.
- Those opting out from the mandatory second pillar must join an Occupational Pension Fund.
- The self-employed, free professions or small enterprises can combine into Open Occupational Funds.

II. The transition period: Guarantees for workers who started work before 1993. Durable and credible guarantees are necessary for all those who are currently under threat of repeated and abrupt pension cuts. Within 6 months from the introduction of the new system detailed operational plans will be compiled to uncover and itemise outstanding commitments, and propose sources of funding sufficient to provide a durable guarantee. However, before sources of finance are finalised, two exercises must be completed to rationalise future costs:

1. Incorporation of all existing primary *and auxiliary* funds into a single entity.
2. Rationalization and consolidation of all current requirements for contributions and revenue.

Today's hidden (implicit) debt will be brought into the open and must be accounted for in detail. This highlights the need, already present but hidden by the complexity of the current arrangements, for extra funds to finance old system pensions. It is clear that this is not a *new* deficit, but only the open manifestation of what will transpire – one way or another – in any case. The funds to pay for old pensions could come from targeted consolidation (e.g. pension age increases), but also from the use of new financial instruments to allow a more equitable spreading of the burden across generations. As a further aid to smooth transition, the fall of contribution rates could be phased in; in a similar fashion the transformation of the contributions of the self-employed to an *ad valorem* basis could be introduced gradually.

The course of the macro economy, may allow the *ex post* award of a growth dividend to pensioners in the coming decade.

Our proposal will provide a growth shock – capable of allowing Greece to break the crisis vicious circle. It will have positive implications in five directions:

1. Pension protection. A young contributor can be reasonably assured that 16% contributions will lead to replacement of final salary of the order of 50%. If he/she further contributes to an occupational fund (4% contribution) an overall replacement rate of 75% could result.
2. Viable state funding. The new system has zero state subsidy. Extra finance is necessary in the transition period to 2045 for pre-1993 workers. The amounts required are no larger than the burdens of the current system.
3. Aid to national debt restructuring. Under this proposal, the pension implicit debt stops growing, a fact which will greatly improve Greece's negotiating position. With the accumulating reserves of the new system, Greece will find it easier to shift the composition of debt from external to internal.

4. New attitudes to saving which promote generational solidarity. The immediate reduction of contributions should free funds so that households and businesses can pay off part of their outstanding debts. Communicating with the insured population on an annual basis on the state of personal pension accounts will promote saving planning for the average family, which can provide the preconditions for future growth.
5. An impetus for growth. Reducing social insurance contributions promotes competitiveness and exports and aids work incentives. Reserves of the new system in its first decade will approach EUR 50 billion, which can finance the investment needed for the macro economy to rebound. The return of the 'New Diaspora' of young qualified people who left the country since 2010 will also be encouraged.In a country which is facing the most acute ageing problem in Europe, this proposal could change social security from being the source of problems to a locus of solutions.

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