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Labour and pensions in the Greek crisis: The Microfoundations of Disaster

Abstract

This paper examines the antecedents and dynamics of the Greek crisis by focussing on pensions and the labour market – the 'microfoundations of disaster'. The crisis was caused by fundamental features of political economy, present before entry into the Monetary Union. The fact that reform did *not* take place until *after* the bailout may be seen as a governance shortcoming, linked to the way major policy choices are handled in Greece. Since the early 1990s, discussion of pensions and of labour flexibility had been avoided, quantification shunned and data withheld, in such a way that issues were bent to fit what was thought politically feasible. Thus, in those two areas, a disjunction was created between appearance and reality, as well as a difference in perceptions between domestic and external commentators. When reform in pensions and employment protection finally came in 2010, it was seemingly imposed from outside. However, the absence of a process through which problems are defined, proposals sought and solutions implemented remained an issue even after the bailout. In this way Greece's recovery process is still undermined by the same governance shortcomings which were responsible for bringing on the crisis in the first place.

1. Introduction: Labour and pensions in the recovery process

Greece since late 2009 has been in the eye of a storm, which, three years later, has engulfed the Eurozone, the EU and threatens the stability of the world economic system. The story of the crisis cannot be told without reference to pensions, nor without considering the set-up and functioning of the labour market. This paper surveys developments in those two domestic policy areas from a political economy stance: First, their role in bringing on the crisis, both actual and perceived; second, the policy responses taken during the crisis and their role in the unfolding of the crisis; and, third, the outlook for the future.

The key hypothesis proposed is that the Greek crisis is, in essence, a crisis of governance. In both policy areas shortcomings had been pointed out well in advance and what needed to happen had been understood for a long time – both inside the country and out. Yet, necessary reforms were not implemented *before* the crisis. When reforms came *during* the crisis, their method of implementation in many respects ended up exacerbating the underlying problems and became part of vicious circle further deepening the recession. Finally, the political response to reform – whether actual, proposed or attempted – threatens to become a key driver of instability in the *future*. The common thread running through all phases is the failure to organise a process of social concertation in such a way that problems are defined, proposals sought and solutions implemented. A large part of the blame will be apportioned to bypassing social dialogue – a way of proceeding to changes 'without society', which ultimately erodes social trust and hence feeds back into inefficient governance[1].

The first section places the discussion into its macroeconomic context – the role that pension and labour reforms are called to play in the general context of 'internal devaluation'. The next section looks back to the role played by the two leading to the crisis. The question explored is for what reason, those warnings which had been authoritatively sounded, were not heeded. The focus then turns to a description of the measures proposed and implemented as part of the crisis response after 2009 in the pensions and labour reforms. The concluding section examines the post-bailout political economy at work. Given this analysis, some final thoughts are addressed to the counterfactual question on whether a possible exit from the Eurozone could, by reclaiming the option of exchange rate adjustment, provide a solution to the underlying problem.

2. The triple deficit and the need for an internal devaluation

In macroeconomic terms Greece in 2009 was faced by what Christodoulakis (2011) calls a 'triple deficiency': an acute public debt and public finance deficit, an equally pressing deficit on the current account of the Balance of Payments and a competitiveness deficiency. The latter, in a sense, was more important than the other two inasmuch as it lay at the root of their causality. [2]

Greece had appeared to have fallen foul of Rodrik's (2011) '*trilemma'*: given that since 2001 was part of the Eurozone, i.e. of a fixed exchange rate currency area, it did not possess the weapon – or the textbook solution – of exchange rate adjustment as a key ingredient of an overall strategy of overcoming the triple crisis.

Such an adjustment programme had been followed with some success in the 1985/7 economic adjustment programme when a 15% drachma devaluation was the first step in a wider programme consisting of fiscal consolidation, governance improvements and vigorous incomes policy (Spraos 1989)[3]. The 1985 programme coincided with the tenure of C. Simitis in the Economy Ministry and was put to an end with his dismissal in 1987. This programme had been succeeded by the 1990/2 programme, put in place by the opposing party and motivated by making up for the perilous public finance situation. Both programmes were accompanied by sizeable loans from the (then) European Economic Community. The two loans were to be disbursed in two tranches, the second of which would have been dependent on certain conditions being met. Interestingly, in *both* cases, only the first tranche was drawn; the then governments declared that they had no need for the second

1 This is the key point of Lyberaki and Tsakalotos (2002), surveying an earlier period.

2 See also OECD, 2007; 2011, IMF, 2010, Hardouvelis, 2011

3 For an overview of the period from the perspective of a political scientist, see Kazakos, 2010.

tranche, hence deftly avoiding being brought to account about plan implementation[4] (Kazakos, 2010 ; 2011, Pagoulatos 2003).

The drachma was devalued once more in 1998, as a key part of the preparation for entering EMU. That was envisaged as a *final* exchange rate re-alignment, prior to the losing the ability to influence competitiveness through this route by joining the European Monetary Union[5]. After the drachma was abandoned in 2001, exchange rates and the terms of trade between Greece and its Eurozone partners were irrevocably fixed and unalterable.

Entry into EMU and the lack of exchange rate adjustments were seen in a positive light, as avoiding repeated devaluations at more or less fixed time intervals. (Hardouvelis 2008). The current account issues were so deeply rooted, that devaluation was no more than a temporary palliative. Entry into EMU, by convincingly altering systemic structural parameters, was part of the answer of dealing with the underlying competitiveness problem.

In this way, Greece at the point of entry into the Monetary Union, was *already* facing a structural problem. Given that devaluation was abandoned as a tool, what is now known as 'internal devaluation' was understood as being the sole means of correcting imbalances in future. Indeed, more than that, setting in train a process akin to internal devaluation was part of the rationale of Monetary Union entry as a means of dealing with entrenched structural problems. This was to have happened by means of a 'virtuous circle' using the Eurozone lower interest rates and the regulatory stability, to lead to the desired internal restructuring.

It is well documented that these hopes were ultimately dashed. Though Greece showed a run of years of high growth, the boon of low interest rates was ultimately not used to promote competitiveness, but (largely) to buttress incomes (Hardouvelis 2011). This became particularly so after 2007: the then Government tried to 'spend itself' out of trouble just as growth rates were falling and interest rates rising. Given that these parameters determine the differential equation that determines the sustainability of debt, the solution of that equation became quickly explosive, with the debt spiralling out of control. The final straw came with the misreporting of the 2009 deficit: European reactions to this served as a correction to the misapprehension that sovereign bankruptcy was inconceivable. The inability to borrow in early 2010 led with mathematical certainty to the bailout in May 2010 (OECD 2011).

The point to retain from this potted history is that, despite the fact that the Greek crisis manifested itself as a macroeconomic phenomenon, its roots and the mechanisms that ultimately led to it were microeconomic and structural in nature. The necessity to resort to 'internal devaluation' was not something that had to be improvised as a result of the crisis in 2009; it was something that was part of the policy *desiderata* from the very beginning of euro entry. The triple deficit faced in dramatic terms in 2009 was not due to a faulty operation of the single currency; it

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4 Featherstone et al., 2001

5 The 1998 devaluation decision was taken in the context of the 'hard drachma' policy, - i.e. to use an overvaluation of the exchange rate to affecting inflationary expectations. This overvaluation implied, however, at the outset a built-in competitive disadvantage of Greek production.

predated it and the membership of the single currency was regarded as a means to overcome structural problems which had been diagnosed before.

The grand project of structural reforms was a large part of the 'modernising' project of the Simitis governments between 1996 and 2004. After all, '*Modernisation'* in the sense of convergence with the West rather than the Oriental or Near Eastern influences was a long standing orientation issue in Greek politics (Diamantouros 1994, Gunther and Diamandouros 2006); in this context membership in EMU can be seen as its crowning achievement. It is significant that in the political discourse of the 1990s 'reform' had a prominent role (Sotiropoulos, 2004).

However it may have been, something akin to an 'internal devaluation' had been part of the reform agenda even before euro entry. After a decade's participation in the single currency, during which the core competitiveness problem was not addressed, the imperative of such an internal devaluation appeared once again as urgent. The following sections attempt to 'unbundle' the notion of the 'internal devaluation' and to examine the role played in that by pension reform and labour market reform.

3. Pensions, labour protection and the origins of the crisis

At the centre of the diagnosis of the structural *malaise* of Greece lay the role of the State. The State was large, it was inefficient, and its functioning consistently favoured groups of the population ('its clients') over others. Its function in the economy was less to supervise the production of wealth than to preside over the distribution of economic rents or 'privileges' (Mitsopoulos and Pelagidis, 2011, Doxiadis, 2010). In so doing, it served as an obstacle to productive initiatives, whether these came from the private or the public sectors. This critique of the role of the state in Greece is thus at variance with 'neoliberal' analyses; it does not focus on the size of the state, nor on the public/private division, but on the way the State operates to further particular interests. The distinction is most obvious in distributional issues: By favouring well-placed 'clients', the operation of the State frequently ends up promoting and not dampening inequality. Such clients could be the well-paid labour force of State enterprises but also groups of private entrepreneurs who complement the State as suppliers or contractors. In a sense, therefore, the State had already been 'privatised' in the sense of serving sectional rather than the general interest.

Whatever the political economy root causes, the Greek crisis manifested itself in public sector deficits, unsustainable public debt and a persistent erosion of competitiveness. What was the role in that of pensions and labour protection?

In the first EU Joint Report on Pension Strategy 2003 (repeated in 2006 and 2009), the Greek pension system was identified as:

1. **Costly.** In 2007 pensions absorbed more than 12% of GDP (OECD 2007, 2011b). The growth of social spending since 1996 accounted for much of the increase in public deficits.
2. **Facing dramatic demographic challenges.** The dependency ratio is expected to deteriorate at the second fastest rate amongst the EU-15, while Greece faces the highest expected pension expenditure in 2060. (Economic Policy Committee 2009).
3. **Economically inefficient.** A multitude of regimes leads to a patchwork of cross-subsidisation and high non-wage costs. The private sector and exports

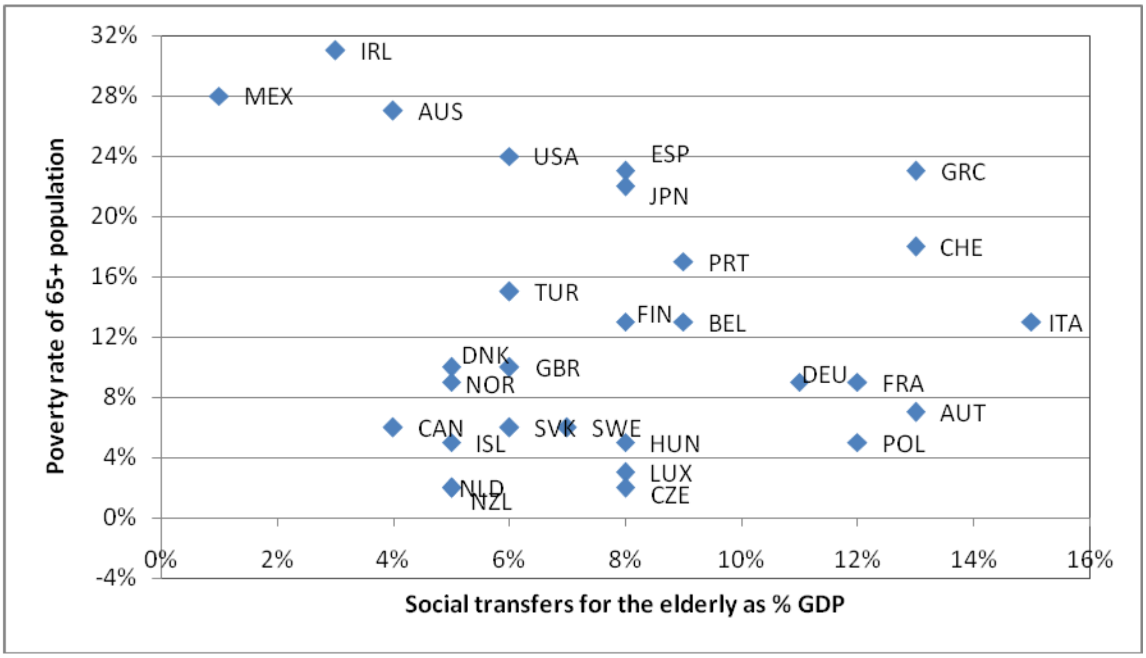
shoulder the brunt of the cost while the public sector retains its privileges. (Börsch-Supan and Tinios 2001).

4. **Socially ineffective.** Official reports admit that 'poverty is grey in colour', afflicting mainly older citizens. Ironically, once a worker transfers from employment to retirement, i.e. from the globalised labour market to the bosom of the Welfare State, his/her risk of poverty *increases* by 50% (Tinios 2010a).

5. **Resistant to change.** Given the above, reform could have pursued social ends without sacrificing economic efficiency – in theory a win-win situation. Yet, at least since 1990 the pension system had been under the verge of a major reform. (Tinios, 2005, Triantafyllou, 2006).

The 'price exacted by inaction' is apparent in Figure 1. The process of widening privileges had created a monolithic and expensive state pension system, with little impact on old age poverty. High pension expenditure is combined with high poverty of the over-65s.

Figure Public expenditure on old age and old age poverty



Source: OECD Pensions at a glance 2007

Pensions were thus a key component of what can be termed 'the microfoundations of disaster'. Deficits and cash shortages would appear in pension providers. Rather than correcting the sources of the deficits, the State would dodge the issue by providing direct budget grants to cover the shortfall. This had the effect of transferring the financing problem of pensions 'up' and 'forward'. The president of the Conferederation of Trade Unions, C. Polyzogopoulos, in an attempt to assuage disquiet about the future of pension stated in 1998: "The pension funds will collapse *after* the State Budget and the economy (do)" (quoted in Tinios 2001, p. 155). Unfortunately, his analysis was prophetic: From a problem facing *individual* pension funds, the insufficiency of funds was transformed to a public sector deficit issue, then to a national debt issue and finally to a Eurozone stability issue[6].

In theoretical microeconomics, reality forces itself on the individual consumer through the 'budget constraint', popularised by Milton Friedman as "There is no free lunch". In the case of Greek pensions, a budget constraint was bypassed through offloading financing from pension providers to the State. Grants to pensions funds came to account for an increasing share of the State budget; at a micro level, expenditure was not limited by available funds. The problem ballooned and domestic sources of finance for the public sector deficit were replaced by external borrowing. The process was brought to an abrupt stop when the ability to tap external borrowing was finally exhausted in 2010. In Italy the consensual 'Dini pension reform' in 1996 was the result of a 'grand bargain', where workers agreed to major pension changes as their contribution to adapting towards EMU – a 'Europeanisation' of the pension problem (Dyson and Featherstone, 1996). In our case, rather than a '*Europeanisation* of the Greek problem', we almost had '*Hellenisation* of the Euro problem'[7].

Labour and labour protection was the other key component of the underlying malaise. Greece in the period since 1974 took a very active interest in legislation protecting employment and incumbent workers. Greek legislation protecting employment is hence, on the OECD scale, one of the most activist (Nicoletti et al, 2000, Burtless 2001).

However, legislative activism was not matched by operational implementation. Employment protection legislation and social protection of workers was enforced where that was easy to do or where it could be imposed by fiat – i.e. in the government and public sector – in a process that has been termed *'Legalistic formalism'*[8]. Its operation in practice guaranteed the position of well-placed groups ('insiders') at the expense of the unprotected and residual groups of 'outsiders'. It would come as no surprise that the insiders were chiefly in protected sectors –in the government, the public sector and the large state-dependent private sector. Outsiders, on the other hand were found in the private sector, or in areas where *internal* protection could not compensate for openness. Employment protection for insiders implied large queues at the entrance of the labour market and a concentration of unemployment among the young (labour market entrants) but also among women. This gender dimension evidenced itself both in persistently larger unemployment risk for women, but also a very low participation rate, especially for mothers of small children (Lyberaki and Tinios, 2011, Nicolitsas, 2012).

The internal devaluation process presupposed the possibility of greater control of unit labour costs; labour as the main non-traded factor of production is a key

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6 The process of escalating pressures shifting the budget constraint up was anticipated in Tinios 2002..

7 Featherstone and Papadimitriou 2008, reviewed by Tinios 2010c..

8 This term is used by Lyberaki (2010) to describe the process of gender balance: Activism in passing legislation was not matched by any measurable success if that was benchmarked against what happened among Greece's European peers. In that case, a self-congratulatory stand if progress is compared to the past seems entirely misplaced if the yardstick is what *could have* happened.

determinant of competitiveness of Greek production. Indeed, the progress of globalisation meant that Greek production was increasingly subject to international competition, which was most evident in traditional sectors such as textiles. For a time Greece was able to contain costs through the advent of immigrant labour. Whereas Greece since the War was a net labour exporter, the collapse of the socialist regimes to its North, brought a sudden influx of immigrants chiefly from Albania, but also from Bulgaria and Romania (Lyberaki, 2008, Triantafyllidou and Maroukis, 2012), amounting to more than a tenth of the labour force. This large and flexible labour force was added to 'outsiders' and was instrumental in keeping labour costs down and aiding competitiveness[9]. Immigrant women by providing a willing supply of care services, allowed female labour participation to increase in the late 1990s (Lyberaki, 2011). At a later stage, Greek small dynamic enterprises tried to use relocation of their activities as a reaction to the competitiveness pressures (Lyberaki, 2010), while there was evidence that returning migrants to Albania acted as go-betweens between that country and Greece (Lambrianidis and Lyberaki, 2004).

These developments did buy some time, but they were from the start unlikely to correct the underlying problem. When the external beneficial stimuli started being reversed after 2005, the competitiveness problem reasserted itself (Hardouvelis 2011).

Indeed, in strategic terms, once the problem had taken an acute public finance dimension, the competitiveness deficit became more decisive and important. The public finance problem after 2009 underlined that future growth could no longer depend on the stimulus of the state. On the contrary, the public debt situation showed that the maximum sustainable size of the State was far smaller than was thought previously. The contraction of the State would, of necessity, have recessionary implications. The only feasible source whereby this could be made up would be private growth – some kind of 'crowding-in' to supplement the contraction of the public activities. In such an environment, labour flexibility would be necessary to 'take up the slack'. Seen from the other end, labour inflexibility would translate to a greater and deeper recession (Blanchard 2012).

A striking reminder that austerity is *not* the main or even the chief driver of the deep Greek recession, was provided by a revision of the Greek National accounts figures during 2011 (Iordanoglou, 2012, p180). Under this revision, GDP is seen to be falling already in 2008, almost two years *before* the first plausible start of austerity in early 2010. Indeed, the stance of the public finances between 2007 and 2009 was expansionary. The State tried to spend its way out of short term political problems. A start was made with compensations for the summer 2007 forest fires, which influenced directly the September 2007 general election. This was followed by generous wage settlements for the military, civil service and pensions in 2008/9, leading to the explosion of the general government deficit to 15,8% in 2009. The chief driver for 2007-9 developments thus could not possibly be austerity; instead the spotlight must fall on competitiveness, liquidity effects and a developing catastrophic confidence climate for the private sector.

9 Its influence was particularly marked in agriculture, construction and tourism.

The current Greek recession is thus in origin and in its primary mechanism a private sector production crisis. Yet in many (press) commentaries, it is seen as something almost exclusively due to austerity and to the reduction of incomes controlled by the public sectors such as pensions. This contrast between perceptions and reality is a theme that will recur in the rest of the paper.

4. The whistle-blowers: Reform inadequacies 1990-2009

We have seen that the importance of employment and pension reform in the general 'modernisation' project was understood – at least in general terms. This understanding was translated into reform initiatives numerous times between 1990 and 2009. The end result of all these efforts was insufficient to prevent the general melt-down in 2009.

The realisation that the Greek economy had to undergo a thorough institutional overhaul, and that this overhaul necessitated a societal dialogue was behind the formation in 1996 of the "Committee for the Examination of Long Term Economic Policy", better known (after its Chairman) as the 'Spraos Committee' (analysed extensively in Featherstone et al 2001) . This independent Committee attempted to bring to the attention of the wider public those areas where reform could further wider aims. Its approach was typified by its most well-known report, that for pensions (Spraos Committee 1997). The 120-page report, modestly entitled 'A Contribution to the public Debate' was at pains to point out that demographic and other factors necessitated decisions to be taken 'by 2007'; it left *specific* initiatives to emerge from the ensuing discussion. Discussion, however, was one of the few things that did *not* ensue; the attempt was maligned, Professor John Spraos was vilified as a plagiarist of Chile and any discussion was postponed. The other reports (on bureaucracy, agriculture, the tax system and incomes policy) were hurriedly taken out of the public domain[10].

After the demise of the Spraos reports in 1997, reform debate was not so much discussion as a series of unilateral proposals emanating from the government (usually following external pressure) to which the interested parties would react, usually in order to safeguard the *status quo ante*[11]. As a result reforms were incremental, inching along in what was perceived as the 'right direction', but without any sense of the distance to be covered.

This model of 'reform by instalments' (Tinios 2005) or more colourfully 'ostrich interventionism' (Tinios 2010a) was most obvious in the case of pensions. *'Ostrich interventionism'* consisted of regular episodes of frantic intervention to satisfy outside pressures, followed by a Nirvana of abandon. At least since the 1990s reform episodes regularly went through a number of phases:

- Pressure built up *outside* Greece to reduce government deficits.
- Public opinion and the media 'discovered' an immediate threat to pensions.

[10] The reports were published by the National Bank of Greece, but were withdrawn from the single outlet where they could have been found within six months…

[11] See Featherstone and Papadimitriou 2008 for discussion of pensions, labour and Olympic Airways

- 'Social dialogue' ensued lasting a few weeks. The dialogue was marked by confusion, strikes in public utilities and frantic side negotiations with separate groups of workers.
- Laws were passed in great haste. They were hailed as of 'epochal importance'. The laws kept the structure of the system and inched along in the direction of the *original* reform trajectory: somewhat lesser distance dividing groups, slightly later retirement ages, slightly fewer exceptions.

Such episodes transpired and laws were passed in 1992, 1998, 2002 and 2008.[12].

The unique feature of this process occurred *between* reform episodes. The whole system would pass into denial, where everyone talked and behaved as if there never had existed a threat to pensions. Processes of reflection were prevented and calls to reform slandered. The same pusillanimity implied that no political actors could withstand a possible accusation that they were *preparing* for reform. Consequently, all technical preparations for future reforms were prevented, *including* the production of necessary data. Tinios (2010, chap 7) comments that the Government in 2010 did not know the age distribution of its own employees; it was hence incapable of projecting likely future outlays. This shortcoming had been first pointed out in 1992. "*When information gaps are consistently pointed at for decades and no action is taken, the suspicion emerges that the lack of statistical information is desired and contrived...Bad statistics can be 'convenient'* " (ibid p 231).

So, when the call (from outside) came to start the reform process afresh, everyone behaved as if a natural catastrophe had struck. Given the short institutional memory of the political system, each reform episode was treated '*as if it was the first time'*. By this point, no time was available for preparations. Solutions had to be sought from the existing tool box[13]. A perennial reform proceeds with many small parametric steps along a path corresponding to some original unchanging blueprint. This resulted in leaving the core problem intact and the basic institutional structure unchanged (Tinios 2012)[14].

Featherstone and Tinios (2006) offer stylised portraits of key actors (Government, Unions, Employers, the financial sector, the policy community, pension fund leaders) and conclude that "the points of view that have an interest in thwarting reform are well represented,... while there is no-one to play the role of the 'advocate of the missing generation'. The result is profusion of veto points and a log-jam, a 'societé bloqué'. The withdrawal of the Giannitsis pension proposals of 2001 (ibid) is, in a sense, the other side of the coin of the temerity of the 2008 'reform'.

The crucial ingredient in the pendulum process was the absence of public discussion[15]. What kept the process going was the autistic reaction after each reform

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For pensions Tinios 2011b, Triantafyllou 2006, Alivizatos 2011 examines the long-term constitutional picture.

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This syncopated reform process applies equally for Social protection reform (Lyberaki and Tinios 2011, Matsaganis 2005) and possibly in wider areas such as constitutional reform (Alivizatos 2011, Marinos et al 2007).

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Monastiriotis and Antoniades, 2009 make a similar point: reform was unsuccessful because it was not designed well, not due to reactions (which were predictable).

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episode, to place wishful thinking above realism by rushing to agree that the 'problem had indeed been solved'. The definition of the problem was bent according to political preferences of the political actors. Hence reality was adapted to the preferred solution, rather than the other way round.

The situation in the labour market was little different. Under the influence of the OECD Jobs Strategy and the EU Employment process, increasing amounts of Community Support funds were earmarked for 'Active labour market policies'. Thus the objective of flexibility became well entrenched, at least for rhetorical purposes, given that it underlay the expenditure of billions of Social Fund subsidies and programmes. The contrast between a pro-flexibility rhetoric and an inflexible reality could not but lead to pressure to move the labour market towards greater flexibility.

Attempts to do so were undertaken in 1990, and again in 1997. The latter, under the Simitis Government, started in tandem with the Spraos committee, appeared more ambitious to start with,[16] but despite being given the grand title 'Compact of Trust', essentially fizzled out. During the 2000s the process was more successful by the simple means of lowering its ambitions (Featherstone et al 2008); this amounted to promoting some 'flexibility at the margin', i.e. applying changes only to the *flow* of new entrants leaving those who arrived earlier unaffected[17]. Such measures could be portrayed as moving towards flexibility, yet in practice created even greater distance between outsiders and insiders.

The key problem in the labour market was created by a legal framework impenetrable to the lay person. Laws built on and frequently supported each other in such a way that changing one particular restriction merely allowed another (less obvious) restriction to take its place. In this way, apparent legislative activism could be translated to very little actual effect on the ground. Alternatively, seemingly innocuous procedural provisions could have major impacts by overwhelmingly strengthening one side at negotiations. One such was '*metenergeia*' (literally 'after-effect') – i.e. the provision that once a fixed term collective agreement ends, its provisions can continue, so long as it is not superseded by another agreement[18]. Another was the use of nationally collectively agreed wage rates as a floor for 100 sectoral and 90 occupational contracts; this floor referred to not only the *level*, but also the *rate of change* of wages. In this way the existence of low levels of wages for some workers can lead to wage increases for others who are far better off. (Lyberaki 2013).

Resistance to public debate in the case of employment protection is, if anything, more marked even than the case of pensions. In many instances the '*hegemonic view'* contradicted reality directly: The poor in Greece are located in sections of

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For the path-dependencies created by public opinion, O'Donnel and Tinios 2003, Tinios and Poupakis 2011c undertake multivariate analysis of the determination of attitudes.

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The then PM memorably praised the example of an 'employable youth' who would fearlessly switch jobs. That example was seen by most as a threat to established practices.

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For a theoretical treatment see Boeri, 2011 and also Lindbeck and Snower, 1988.

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. This previously little-known feature achieved notoriety when an attempt to abolish it by Troika, led to a shocked query by Unions as to *"who had let the foreigners in on the secret?"…*

(usually precarious) employment little affected by the minimum wage[19]. What is key in this, as in other areas, is the use of arguments supposedly furthering 'deserving cases' (the poor, women, underprivileged) in order to bolster the case of employees who are well above the minimum. For instance, given that increases of minimum wages are taken as the point of departure for sectional collective bargaining, securing a large minimum adjustment is translated into larger increases down the line (Burtless 2001). It goes without saying that securing high legal protection and high pay is most effective in sectors protected from competition or enjoying dominant market position; otherwise competition would erode these 'privileges' away. According to Lyberaki 2012, domestic discussion of labour and employment issues builds on a consensus around nine positions which can be characterised as a '*credo'* , in the sense that belief in them is independent of evidence[20]. The absence of a challenge to the items in this '*credo'* operates like a kind of protective wall of silence around the employment situation; it justifies the 'hands off' attitude about the labour market, which characterises both the side of employers and employees in the labour market (Matsaganis 2007). The ill-tempered and confused discussion on the desirability of changes to the minimum wage legal framework that characterised early 2012 may be interpreted in the light of those misapprehensions[21].

Thus, in both pensions and employment domestic discussion could not promote reform and was, indeed, one of the key mechanisms preventing it. Given that both these issues were subjected to structured discussion and argumentation at a European level, a body of evidence and understanding was accumulated which was immune to the domestic defensive mechanisms. This involved the collection and availability of well-understood, internationally comparable data (for employment Lyberaki 2008) and benchmarking and sustainability analysis in the case of pensions (Tinios 2012).

The existence and operation for almost a decade of international comparative exercises was shrugged off in domestic discussion. No political adrenaline flowed from a statement that the pension situation would become critical '*after 2025';* if time is measured in electoral cycles, 2025 was 'too far ahead to worry about'. Bond traders, nevertheless, take a longer view: to rate the repayment prospects of debt, they have to consider the conditions prevailing when repayment is due to take place. When the EU Open Method of Coordination provided projections allowing such a view (EPC 2009), markets (and bond markets especially) took notice, even if domestic policy makers continued to look the other way. Faced with a 'defective telescopic faculty' on the part of governments, bond markets supplied the missing 'telescopes' and *forced* reform to take place. Similarly for employment, outside bodies had

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19 Mitrakos and Tsakloglou, 2012, Zografakis and Spathis, 2012, Lyberaki et al, 2010. The link between minimum pensions and the minimum wage was severed in 1990.

20 To mention but a few points, labour cost constitutes only a fraction of total production costs, minimum wages apply only to 15% of the employees, restraining wages deepens recession, wages in Greece are too low anyway etc.

21 The annual report of the Labour Inspectorate documents in detail (>200 pages) the activities of labour inspectors, without any attempt to measure what part of the labour market they are affecting.. (Labour Inspectorate 2012).

accumulated data and years of analyses that placed them at an advantage over domestic interlocutors.

As a result, when and if an external crisis would take hold, these international processes ensured that the creditors would have an independent *agenda* of items immediately to hand. Such an agenda could not but place pensions and employment protection very close to its centre. However, the different understanding of the operation of pensions and employment between domestic and international commentators could also pose problems for the future. To the domestic contrast between perceptions and reality was added a different understanding between external and domestic players.

5. The post memorandum crisis response

When the time of reckoning came to pass – i.e. in May 2010 with the Memorandum of Understanding (IMF 2010, Mitsopoulos and Pelagidis 2011, Kalyvas et al 2012) – the reform strategy was passed on a simple argument of “*There is no Alternative*”. This was applied to the pension reform law (law 3863/10), as well as to the labour flexibility changes appended to. The internal political establishment ‘washed its hands’ of reform proposals, by citing external compulsion by the Troika[22]. This stance much simplified the PR problems of justifying about- turns, but stoked up legitimisation problems for the future – encountered less than a year subsequently.

The July 2010 Pension reform was the first major piece of legislation passed after the MoU[23], praised by international bodies (in the hope of being emulated in *other* areas of government activity) IMF 2010b, OECD 2011b.

The preamble of L3863/10 stated boldly that “our objective is to change the system radically” (Parliament 2010). However, the tensions and compromises in its preparation are evident in the length and complexity of the law (99 articles in 55 pages).[24] Nevertheless, there is general agreement that the law is far more drastic than its predecessors. Four features of the law can serve as summary (for details see OECD 2011, Matsaganis 2011, Tinios 2010b):

1.**‘New’ State 1st pillar system** for the very long-term. This is composed of a two - tier PAYG pension system –to begin in 2015 on a *pro rata* basis. If careers remain as short as currently (*c*. 25 years’ contributions), the new system will prove less generous. However, should careers match those in the rest of the EU (40 yrs) replacement rates will be equivalent to current ones. Retirement ages increase rapidly in a step fashion (especially for women less than 30).

2. **Fund consolidation** for *primary* pensions. The consolidations are largely cosmetic (i.e. sectoral differences are preserved within the larger funds), with the notable

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22 eloquently paraphrased by a minister as the Troika ‘forcing us to act against our conscience’

23 The recent German increase in retirement age predisposed the course the reform was to take.

24 Katroungalos and Morfakidis 2011 analyse from a legal standpoint the difficulties of implementation and the inequities created. They interpret the obvious technical shortcomings of the law as due to haste in its preparation.

exception of new hires of civil servants, who will be insured from 2013 in the private sector fund (IKA).

3. **Extensive grandfathering measures** for those close to retirement, preserving rights to lower retirement ages and replacement rates. Though no projections were ever released, these measures could largely exempt cohorts to retire by 2020. These provisions could be used as a form of early retirement to facilitate the shrinking of the public sector, especially among women.

4. **Preannouncement of future retrenchment**. A number of changes were preannounced.[25] Yet in mid-2012, none of them had been implemented. They are likely to haunt political developments in the second half of 2012.

The criticism is often voiced that the Greek austerity programme is directly due to the implementation of a 'neo-liberal agenda'. Such an agenda – at least in its Latin American variant – included a privatisation of pensions as its central feature (e.g. Diamond and Valdes-Pietro 1994). European reforms since the 1990s all included the strengthening of the second and third pillars (Tompson 2011, Tinios 2012). Yet, the Greek reform, despite the monolithic character of the system, conspicuously failed to move in any direction encouraging non-State pillars. Thus, rather than a neo-liberal revolution, the pension reform can best be seen as a defence of the exclusively state-run first pillar system. Despite the fact that the law has some innovative features, it is easier to characterise it as part of a defensive (or even palliative) strategy to contain change, rather than a bold attempt to use pension policy as part of an internal devaluation process aiding competitiveness.

The driver for promoting competitiveness was assigned by the troika to **the labour market reform**. The post-MoU intervention had three key objectives: (a) retrenchment in public employment (b) structural change towards efficiency in the labour market (protection, flexibility in contracts and time use) and (c) rationalization of the cost of labour. The last item was exorcised in domestic discussion; the unions believed pay was too low anyway, while employers' organizations were unwilling to open any discussion that would 'spoil' the consensus. Interestingly, despite their rhetoric, individual employers made free use of practices, which were in open contravention to their stated positions (e.g. undeclared labour, contribution evasion). The Memorandum of Understanding, from its start, gave pride of place to a raft of changes in labour protection. A large number of separate provisions were legislated, many of which had been the object of past discussions (or even past legislation which had remained dormant); these changes generated much heat and gave the impression (certainly to local commentators) of a regime change towards enshrining flexibility. However, the changes were piecemeal in nature, in some cases lacked essential preconditions of implementation[26] and in no way constituted a coherent whole. In this way, the key *desideratum*, which should have been a change in the rules of the game in the labour market , was not achieved. In particular, there was

25 If the 2060 projections to be produced are more than 2.5 percentage points of GDP higher than 2009 (down from 12.5pp), then supplementary measures must be taken (Safeguard clause). Measures preannounced for 2011: 'Reformulation of Arduous and Unhygienic Occupations', Disability review, Changes to auxiliary pensions subject to actuarial reviews.

26 For example: through delays in issuing administrative acts needed; absence of monitoring infrastructure; legal prevarication and even outright bureaucratic subversion.

no apparent urgency given to reducing the distance separating privileged insiders from outsiders; the labour market was seen as an undifferentiated whole, a fact which opened the door for across-the-board changes in preference to focused interventions.

Even so, many innovations were not implemented in practice, chiefly at the initiative of the Employment Minister. Thus the troika had to come back to ask for implementation plus more changes in the context of the medium-term framework discussion (summer 2011) and again in the context of the structural changes supporting the second bailout (March 2012).

The labour protection changes apparently had little success in promoting employment or even in altering long-established characteristics such as youth and female unemployment[27]. Specific explanations for this are: (a) the cost to employers of redundancies is still far greater for white collar rather than blue collar labour (b) the private sector has to bear the brunt of unemployment and job insecurity (c) liberalization and opening of the product markets and abolition of restrictive entry practices proceeded far more slowly than planned; thus the possibilities of taking up slack were limited and (d) rather than contending with privileged and politically powerful groups, it was easier to proceed with across the board cuts.

Thus the picture on employment, as with pensions, was one of prevarication and reluctance to implement changes that had been agreed, or even legislated. The attempt in both cases was to keep familiar structures and incentives going for the longest possible time and to limit the number of those affected. This is feasible in those areas where legal protection can be effective, in practice protecting privileged sectors; for sectors open to competition or the liquidity squeeze, which are hit directly by the crisis, employment protection would be largely irrelevant.

Though pensions and employment taken singly did not change much, the macro-environment *outside* was radically different (Kazakos 2011). The rules of the political economy game had changed.

Firstly, the Memorandum added to the political economy game a new player with firm veto power– the Troika as the single creditor - as well as new rules. International organizations, whose role hitherto was to comment from the sidelines, suddenly took centre stage as instigators of policy. Close monitoring of the very complex and fragmented social insurance system, as well as redoubled efforts to improve budgeting and monitoring of budget executions are all new experiences. On the other hand, the presence of the Troika, provides an easy target and a focus for populist opposition. A further side-effect, is that domestic players in practice feel no need to propose alternatives, other than to comment on troika initiatives from the sidelines. The different and conflicting viewpoints and understanding of the issues were sure to add to friction.

Secondly, the old Milton Friedman adage of *'There is No free Lunch'* – i.e. a hard budget constraint - is rigidly enforced in its hardest version. The inability to borrow means that *a*ll initiatives are costed as to their public finance impact – which is understood as the overarching objective. The fact that the Troika is the only realistic source of loan finance implies shortfalls must be made up *in the same time period*. A

27 For a recent overview of developments see Nikolitsas 2012. Kavounidou 2012 looks at migration.

retreat in one part of the programme has to be made good with extra measures in another (and cannot, as previously, be simply added to the total government borrowing).

These two developments *de facto* implied a new way to solve the annual budget constraint of the pension system. Overruns previously simply led to an increase in *ad hoc* grants and a rise in overall State borrowing. In the post MoU world, this is blocked by an effective budget constraint. If structural reform cannot lead to specific 'deep cuts', as budgeted, this has to be made up by across the board generalised cuts or taxation hikes. The latter are essentially a systematic 'unforeseen consequence' of reform procrastination. In the case of pensions, this 'unforeseen consequence' was solved by cutting *existing* pensions across-the board on a total of *ten* different occasions between May 2010 and March 2012 .[28] This fuels pensioner insecurity and militates against the very *raison d'être* of public pensions.

In the field of employment, prevarication and guerrilla warfare over implementation of flexibility also operated by placing a *greater pressure* at the margin(see Boeri, 2011, ibid). For as long as the old privileged sectors are still *de facto* protected, the distance the *unprotected* part of the labour market has to travel was correspondingly increased[29]. This only reinforces the dual nature of the labour market; the persistence of open policy questions further increases the extent of policy uncertainty.

The upshot was a classic Keynesian story: prices and wages remained higher and the totality of adjustment had to come from the side of quantities. In other words, unemployment was higher than otherwise and a demand multiplier made matters worse.

6. Prospects for the future

If one adopts a micro-economic reading of the Greek crisis, the same behavioural mechanisms and incentives that were responsible for driving the economy to the edge, persisted in operating after 2010 when policy was trying to bring it back to solid ground[30].

Why was this lesson missed – both before and after the crisis? Why was the system allowed to take the country to the brink; why does its operation, years into the crisis, not change?

We have seen that the political system could evade the consequences of its choices. It could do this through the studied lack of quantification, as well as by the absence of accountability. The latter was made possible by non-transparent system of

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28

The ten separate Pension cuts are itemised in Petroglou 2012. More will follow in autumn 2012. Pensioners' incomes were further curtailed by income and property tax changes.

29

The conversion of existing full time contracts into part-time increased by 73.2% in 2011 and in cases of job sharing by 632%, both of which could be promoted by a unilateral decision on the part of employers; this alone would serve to disprove the employers' contention that labour costs are of no importance

30

Most commentary on the Greek crisis concentrates on macro magnitudes and pays little attention to the 'microfoundations of disaster'. See however Doxiadis 2010, Pelagidis and Mitsopoulos, 2011.

accounts. 'Greek Statistics' has become notorious; nowhere was it more in evidence than in the operation of the pension system[31]. Operating in a statistical haze enables policy makers to reconcile the irreconcilable and to pass on their responsibilities. Similarly in the case of employment meaningful debate never really took place, chiefly for participants willing to steer clear of the '*credo'* and to challenge the status quo..

Alas, the post-MoU experience indicates that past habits of problem denial have not gone away: The reluctance to engage in societal dialogue remains. The flow of published data on the pension system has dried up: The '*Social Budget'*, an annual publication published since 1963, stops in 2009 (data prepared in 2008), while IKA published statistics have stopped in 2006. This is *not* because data are not produced. Indeed, the production of accurate data was one of the priorities identified by the Troika, who seem satisfied with progress on this front; indeed the quarterly troika reports are a valuable source of information (e.g. IMF 2012).m The information produced is communicated to the Troika – *and to no-one else*[32]. The Government appears to prefer to talk only with the Troika and is concerned to discourage any discussion inside the country; the intentional stopping of the flow of quantitative information is part of that strategy.

In a similar vein, reluctance is once again evident to limit benefits of powerful groups. Ambiguity in implementation and retrospective changes of retirement conditions add further to legal insecurity. In *employment,* the inability to acknowledge the rationale of measures 'imposed' by the troika, fed into the wholesale denial and demonization of flexibility. It is enough to point out that political parties who in March had agreed to measures in the second bailout, were promising to do away with them in the May 2012 elections...

To the familiar mechanisms of ostrich interventionism *('no data, no discussion'*), the MoU period added a '*no ownership'* proviso, borne of the need to stress their external origin so as to counterbalance their unpopularity. 'Lack of ownership' leads naturally to an aversion towards any discussion of the shape of pensions post crisis, or of the reasons for greater labour market flexibility. Thus, should these aspects have to serve a strategic role in the recovery, this would be seriously compromised.

As the post bailout period wears on, the memory fades of the reasons why a memorandum had to be agreed in the first place. In the dominant narrative (that was endorsed by a large fraction of the electorate, Gerodimos 2012) the culprit for the nation's ills was the austerity imposed by the Memorandum; the demand to take things back to where they stood in 2009 was explicit in some cases, implicit in others. The disaster that hit the country is appreciated in strictly macroeconomic terms. The *mechanisms* that led to it – the microfoundations of disaster – are largely forgotten in public discussion[33]. Yet, and this is the point of danger, they are all too evident in the everyday operation of economic policy.

31

Indeed, the one case of meaningful systemic pensions reform in the post-euro era was directly due to the need to apply International Financial Reporting Standards (IFRS) to large companies and banks. (Tinios, 2011a).

[32] As a further example, new pension projections by the Acturial Authority in late 2011 will only become known when the Commission publish the Ageing report for EU-27 in autumn 2012…

33

This paper was written in the immediate aftermath of the 2012 elections,. Those elections appeared to pull the country back from the brink. So, what can be the prospects for the future?

It must be obvious from the above analysis that continuation of current trends is not viable in the medium term. We have seen that denial of problems generated almost immediate 'unintended consequences', which pushed the economy further down. As long as underlying issues are not faced in their true dimensions, no policy initiative would be credible. The continuation of policy flux would create further uncertainty, erode confidence and would compound the severe liquidity strains already experienced.

The analysis of this paper lays almost exclusive emphasis on domestic factors for the origins and mechanics of the Greek crisis. Something like this crisis would have happened, irrespective of Eurozone developments. Yet it is undeniable that those developments influence the environment in which a Greek solution is sought. If efforts to boost competitiveness begin to bear fruit, those would be aided greatly by a more expansionary stance in export markets. It is also true that structural reform is very difficult if it has to be combined with a severely restrictive fiscal stance. Yet it remains the case that it is deep structural imbalances that need to be addressed; solely improving the demand side, would amount to papering over the cracks and simply preparing for the next crisis. Nevertheless, developments in Eurozone governance remain important in providing an objective that is worth striving for – once the Greek adjustment is complete.

What of the route exorcised by the entire Greek political class – an exit from the Eurozone? Would the shock of exiting the common currency, together with the recovery of control of exchange rate be sufficient to pull Greece out of the morass, as standard international economics textbooks would expect?[34] Austerity would not be avoided anyway; on the contrary, it would become even more 'brutal' because there would be no fine-tuning, nor discretionary exemptions. From the point of view of pensioners, such a route could be disastrous by leading to the drastic curtailment of the real value of pensions and other fixed incomes. However, even if that objection could be overcome, the exit strategy has to provide an answer to a key contradiction: The absence or insufficiency of reform that led to the emergence and depth of the crisis were ultimately due to governance shortcomings. Managing a vigorous independent exchange rate regime, by widening the field for decisions, places greater demands on governance capacity. If that capacity has proved so unsatisfactory so far, where would the *greater* capacity to make the drachma policy successful come from? Policy outside the euro would falter for the same reasons that undermined euro membership – i.e. the capacity to govern effectively.

Rose 2011 discusses the distinction between macroeconomic problems and their perceptions at the micro level.

34

Some simple-minded commentators identify the euro with pressures to reform; leaving the euro would be a substitute for unpalatable reforms…

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