SOCIOLOGIA
ON LINE
Revista da Associação Portuguesa de Sociologia

South-European Pension Systems: Challenges and Reform Prospect

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Keywords: economic crisis, pensions, Southern Europe

Abstract
The paper analyzes the challenges faced by Spain, Italy, Portugal and Greece in the context of the current crisis and the impact of the latter on the debate regarding pension reform strategies. Furthermore, it assesses the extent to which enacted or proposed reforms address the longstanding challenges faced by these pension systems. The paper therefore provides an insight in terms of what needs to be done and what is being done to improve public pension systems' performance and their long term sustainability. The cross-comparative analysis shows that while some of the measures are well targeted, significant variation exists across these countries.

1. Introduction

The global financial crisis has resulted in one of the most pronounced recessions of the world economy in the post-war era, with profound and lasting effects on Europe's

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economies. Across the region, GDP fell by 4 per cent in 2009, while unemployment is approaching 10 per cent. Meanwhile, government deficits are reaching 7 per cent and debt levels have increased by 20 percentage points over the past two years, undoing almost twenty years of efforts towards fiscal consolidation (Commission EC, 2010a).

The crisis has also highlighted the interdependence of European economies and the potential negative spill over effects from one country to the other, while it has also revived long-held concerns regarding the potential impact of Southern Europe on the sustainability of the euro-zone. The drive to improve public finances in these countries has led to initiatives to implement further reforms in public pension systems, whose generous benefits and imbalances have been cited by experts and EU institutions as a source of concern for the sustainability of public finances (Commission EC, 2010a). However, when assessing the particular effect of the crisis and the reforms being proposed, it is possible to observe certain variation across the four countries of Southern Europe under study, i.e. Portugal, Spain, Italy and Greece.

Against this background, the first aim of this paper is to understand this divergence in outcomes. We argue in particular that the timing of the crisis coupled with the "vulnerability" of pension systems play a key role in explaining the divergent outcomes. In the cases of both Spain and Greece, the economic crisis affected public finances and the labour market significantly, with unemployment levels affecting contribution levels in PAYG systems that still provide largely generous benefits, thus raising the concern for a deep reform. By contrast, while the effect of the crisis has also been evident in Italy and Portugal, the reforms of the mid 1990s (in Italy) and 2005 (in Portugal) have already resulted in a significant reduction in future pension payments. Thus, although economic and social indicators in these countries have also worsened with the crisis, there has not been a significant rush for implementing significant cost-containment reforms in these countries. Second, we also aim to assess the impact of the recent crisis on public pension provision in each country. To this end, we assess the extent and the ways in which the proposed reforms address the issues of benefit adequacy and financial sustainability.

The paper proceeds as follows. In the following section we develop further our theoretical approach based on some key political economy concepts. We then provide an overview of the effect of the crisis in the four analyzed countries and of the reforms adopted in each of them. The last section analyzes in a comparative perspective whether the reforms being implemented address the issues of adequacy and sustainability.

2. Crises, performance and pension reform

The political economy literature has explored at length the role of crises in sparking structural economic reform. For example, in developing countries, Bates and Krueger (1993: 452) have argued that “crises are perhaps the most frequent stimulus for reform”. In a same vein, Tommassi and Velazco (1996: 14) conclude that “economic crises seem to either facilitate or outright cause economic reforms.”

In developed countries, the agreed scholarly vision is that crises also act, at least, as facilitators of structural economic reform. For example, Aberbach and Christensen (2001), illustrate that economic crisis play a key role in public administration reform by opening a “window of opportunity” for passing structural reform measures. In the same line of argument, Alessina et al (2006) argued and empirically tested that structural economic reforms are more likely to take place in times of crises. However, other scholars cautioned about the fact that crises per se may not be sufficient to explain the content of a specific package of reforms (Tommassi, 2002).

In the field of pension policy, many scholars have argued that economic crisis play a key role in initiating structural pension reform processes. In developing countries, Madrid (2003), Kay (1999) and Mesa-Lago and Muller (2002) – among others - showed that the economic crises of the late 1980s and early 1990s facilitated the road for structural pension reform in Latin America. In developed countries on the other hand, Natali (2004) illustrated how the crisis and near bankruptcy of the old public pension system in Italy helped to raise awareness and gather support in favour of the structural reforms that took place in the mid and late 1990s. In a similar vein, Overbye (2008) argues that the economic

crisis of the early 1990s played a role in facilitating public and societal actors' support for structural pension reforms in Sweden during the mid 1990s.

While the role of crises in facilitating significant reform seems clear and well supported by the empirical evidence, there is less support for their role on influencing specific reform outcomes. In this sense, influential political economy analyses such as those of Drazen and Grilli (1993) and Tommassi (2002), as well as some classical pension reform analyses such as those of Myles and Pierson (2001), illustrate that economic crises may act, at best, as a facilitator for significant reform. Therefore, the specific reform outcome will depend on domestic variables.

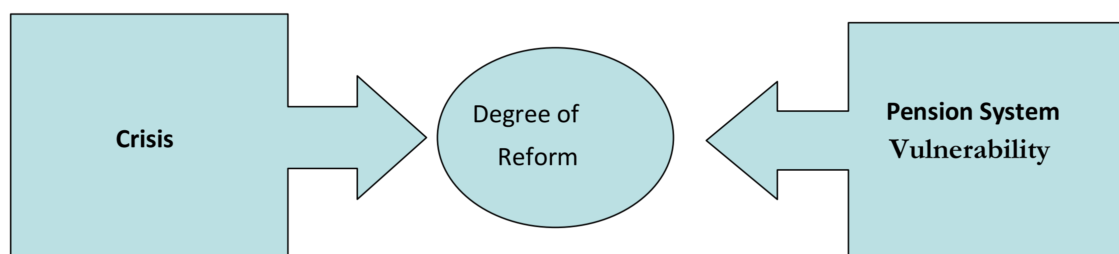
We posit that central to understanding why crises may or may not spark a drive for pension reform in the countries under study is the vulnerability of the system and the extent of reforms prior to the beginning of the economic downturn. Scholarly pension reform analyses give some support to this expectation. In their analysis of episodes of reform in Latin American countries, Mesa-Lago and Muller (2002), Madrid (2003) and Brooks (2008) – among others – have well documented how the poor performance of public pension systems since the 1970s determined the type of structural reform adopted once the full swing of the crises hit these systems in the late 1980s and early 1990s.

Likewise, in Europe, some scholars have shown that countries with pension systems on the brink of collapse were the ones that enacted quite significant pension reforms in the 1990s and early 2000s. In his analysis of pension reform in Eastern Europe, Orenstein (2005) found that the poor performance of public pension systems in this region was key in explaining the drive for significant reform in the mid 1990s, which included a significant reduction of the role of first pillar public pension systems and the introduction of a mandatory private managed pillar. In Western Europe, Natali (2004) showed how in Italy the mismanagement and the persistent deficit levels of the old public pension system helped to garner support from key policy makers and even social partners for its structural reform in the early 1990s. Also in this region, Anderson (2006) and Overbye (2008) explained that the crisis of the old public pension system in Sweden in the early 1990s, mainly triggered by the rise in unemployment levels and the consequent fall in

contributions, pushed pension reform to the top of policy makers' agenda and helped garner support for the reform. A similar conclusion was reached by Schludi (2005) in his comparative assessment of pension reform across Austria, France, Germany, Italy and Sweden.

In sum, the empirical evidence of recent pension reform episodes gives support to the expectation that significant pension reform may take place if an economic crisis is also combined with the pension system's vulnerability. A public pension system displaying vulnerability may be characterised by -among others- high current and projected deficit levels, low contribution levels as a consequence of high unemployment and the persistence of generous arrangements that entail pension benefits that replace a high proportion of income before retirement. We posit that our theoretical expectation helps to explain recent developments in Spain, Portugal, Italy and Greece. Figure 1 presents our theoretical expectation

Figure 1: Theoretical Expectations



In terms of assessing the reforms currently being implemented, we argue that two broad dimensions must be taken into account in assessing the systems' future vulnerability: financial sustainability and benefit adequacy. Financial sustainability has been the main focus of many reforms implemented in this region and elsewhere since at least the 1990s. Typically, when using this criterion, experts must evaluate whether reforms help to secure the long-term financial sustainability of a pension system. Typical indicators to look at are the current and projected pension spending levels, current and

future ratios of contributors to retirees and current and future replacement ratios, which is the ratio of income before retirement that is being replaced by the pension benefit.

Benefit adequacy is a dimension that has often been overlooked when analyzing the impact of reforms. This dimension aims to describe the extent at which pension benefits cover the basic financial needs of current and future retirees. Researchers who focus on this dimension typically look at current and future pension benefits levels and to other socio-economic indicators such as poverty levels among the elderly before and after social transfers. We claim that in order to comprehensively evaluate the different reforms currently being discussed and implemented in Southern Europe, it is necessary to employ not just one but *both* dimensions. By so doing, we may get a better grasp of the overall impact of reforms.

Before proceeding to the more in depth analysis of the reforms undertkaen in the countries under study, the next section describes the general effect of the current economic crisis across Southern Europe. The main purpose of this section is to provide an overall description and identify which countries are more likely to implement more significant reforms, following our theoretical expectation.

3. The effect of the crisis on southern european economies

One of the distinguishing aspects of the recent crisis in Southern Europe is that the crisis did not have a local origin as the banks in this region are still highly regulated and had therefore very low exposure to US “toxic assets” (Verney 2009: 4). While we agree with this observation, we argue that the reasons for the different impact of the current crisis in each country (and the consequent responses) can be traced back to the period of high economic growth that followed the entry into the final stage of the Maastricht Treaty in 1999.

In the years preceding their entry into the euro-zone, the four countries under study underwent significant reforms to put public finances in order so as to achieve the Maastricht’s Treaty key convergence criteria of a government debt below 60 percent of

GDP and a budget deficit below 3 percent of GDP.[1] While the link between EMU and pension reform is difficult to support, EMU countries have on average been more reform-oriented than others within the OECD; yet, they still lagged behind in terms of the extent of the reforms when compared to non EMU countries such as Denmark, Sweden and the UK (Pochet, 2006). As argued by Featherstone (2001) "the opportunity to use EMU to secure strategic interests and/or promote shifts of policy ideas is more evidently linked to the type of conditions prevailing within domestic settings" an argument explaining the postponement of reforms in the Greek case.

Once these criteria were met (with the exception of the one on government debt for Italy and Greece) interest rates fell significantly and cheap credit became available, fuelling a consumption and economic growth, with still some variations across the four countries. In this scenario, fiscal discipline was loosened and governments did not show the same commitment to rein on public finances as in the period before 1999. The following table shows data on real economic growth rates since 2000.

Table 1: Real Economic growth

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Greece	4.5	4.2	3.4	5.9	4.6	2.2	4.5	4.5	2	-2
Spain	5	3.6	2.7	3.1	3.3	3.6	4	3.6	0.9	-3.6
Italy	3.7	1.8	0.5	0	1.5	0.7	2	1.5	-1.3	-5
Portugal	3.9	2	0.7	-0.9	1.6	0.8	1.4	2.4	0	-2.6

Source: Authors' elaboration upon data from Eurostat

Data in Table 1 shows some interesting patterns that allow differentiating, at a first glance, how the crisis would then impact on these countries once the abundance of cheap credit came to an end. In terms of economic growth, Spain and Greece showed a

[1] The other two convergence criteria were: a) an inflation rate that did not exceed 1.5 per cent above the average rate in the three lowest inflation EU countries by 1998, b) long-term (government bond) interest rates at a maximum of 2 per cent above the average in the three lowest rate countries.

cumulative real economic growth of 3.6 and 4.2 percent per year. By contrast, Italy and Portugal lagged behind at 1.4 percent per year in both cases. In explaining the high economic growth rates in Spain and Greece we should note the significant contribution of the real estate sector; in Spain, according to some accounts, the real estate sector accounted for more than 75 percent of all employment created in the last ten years (Royo, 2009). Meanwhile, in Greece the weight of the real state sector in the overall economic expansion was also quite significant (Pagoulatos and Triantopulos, 2009). By contrast, the consumption and real state boom was more moderate in Italy and Portugal.

Regarding public finances, data in Table 2 shows the evolution of government budget balances over the same period of time. As it is possible to observe, with the exception of Spain from 2005 to 2007, the other three countries experienced deficits that, in the case of Greece reached over 7 percent of GDP in 2004. Meanwhile, while Portugal's budget deficit peaked above 6 percent in 2005, it was later reduced within the limits imposed by the Maastricht convergence criteria. As the crisis unfolded in 2008 and governments implemented stabilization programs, budget deficits skyrocketed. However, it is interesting to note that only in Spain and Greece deficit levels increased much more than in Italy and Portugal.

Table 2: Governments Budget Balance

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Greece	-3.7	-4.4	-4.8	-5.7	-7.4	-5.3	-3.8	-5.4	-7.7	-13.5
Spain	-1	-0.7	-0.5	-0.2	-0.4	1	2	1.9	-4.1	-11.2
Italy	-0.9	-3.1	-3	-3.5	-3.6	-4.4	-3.3	-1.5	-2.7	-5.2
Portugal	-3	-4.3	-2.9	-3	-3.4	-6.1	-3.9	-2.7	-2.9	-9.4

Source: Authors' elaboration upon data from Eurostat

Table 3 also shows some differences in terms of the evolution of public debt. Over this period Spain managed to reduce debt levels from above 55 percent of GDP in 1997 to

barely above 39 percent in 2008. However these levels skyrocketed in 2009 as a consequence of the full impact of the crisis. Over the same period, Portugal's debt levels increased, although moderately, from 55 percent to 66 percent in 2008. In 2009, the ratio would also increase as a consequence of the crisis.

Table 3: Public Debt (as percentage of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Greece	103.4	103.7	101.7	97.4	98.6	100	97.8	95.7	99.2	115.1
Spain	59.3	55.5	52.5	48.7	46.2	43	39.6	36.2	39.7	53.2
Italy	109.2	108.8	105.7	104.4	103.8	105.8	106.5	103.5	106.1	115.8
Portugal	50.5	52.9	55.6	56.9	58.3	63.6	64.7	63.6	66.3	76.8

Source: Authors' elaboration upon data from Eurostat

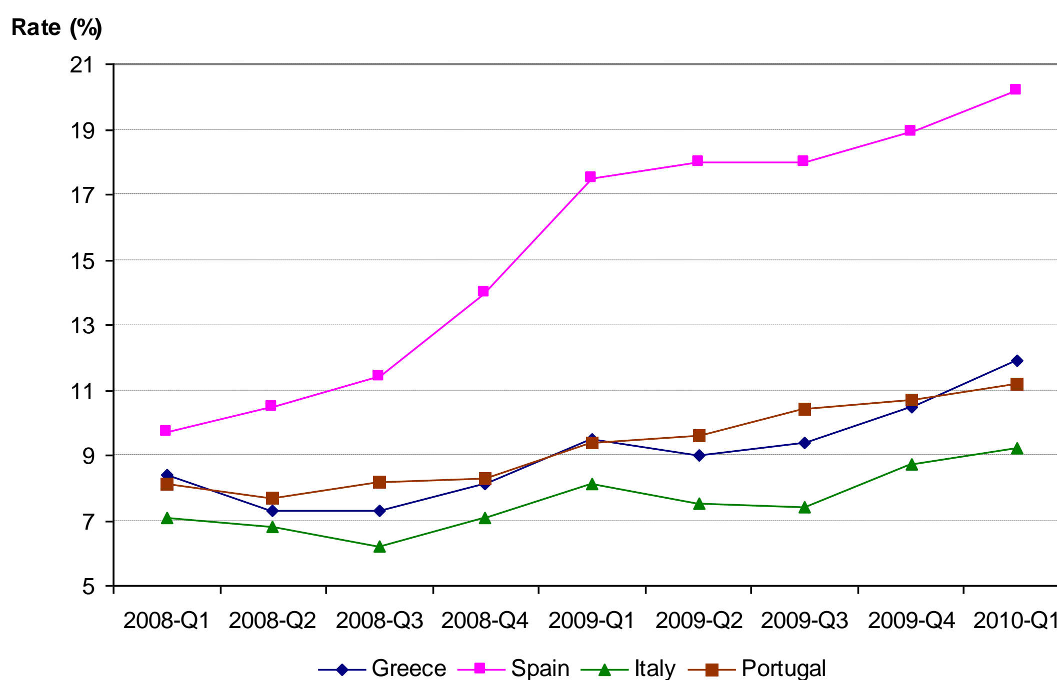
By contrast, Greece and Italy still showed relatively high levels of public debt, with both hovering above 100 percent of GDP during the period under analysis. However, one significant difference is that non-residents hold more than 79 percent of total government debt in Greece, while they amount to 75 percent in Italy, 55 percent in Spain and only 45 percent in Italy (Eurostat, 2010). Thus, as the crisis unfolded, the Greek government was highly exposed to foreign investors who became increasingly worried about the government's repayment capacity. The same was true, to a lesser extent, for Spain and Portugal.

The overview of the situation prior and during the crisis in Southern Europe allows us to distinguish two paths. On the one hand, Greece and Spain experienced a consuming boom and strong economic growth. However, this was not paralleled by a healthy evolution in public finances. As the crisis affected them in full swing in 2008, both countries were found in a very weak position. Meanwhile, while Portugal and Italy would also feel the impact of the crisis severely, budget deficit levels did not deteriorate as much as in Greece

and Spain. While Italy still boasts high levels of debt to GDP, the fact that most of it is held domestically has helped it to avert the full impact of the crisis.

As we initially theorized, the impact of the crisis together with the particular evolution of the public pension system may help us in understanding the rush for significant reforms in Spain and Greece and the lack of a similar drive in Portugal and Italy. We must also highlight that the vulnerability of public pension systems is quite dependent on unemployment levels. Figure 2 compares the evolution of the unemployment rate across the four countries since the first quarter of 2008. It is possible to see that Spain and Greece boasted the highest levels.

Figure 2: Unemployment rate

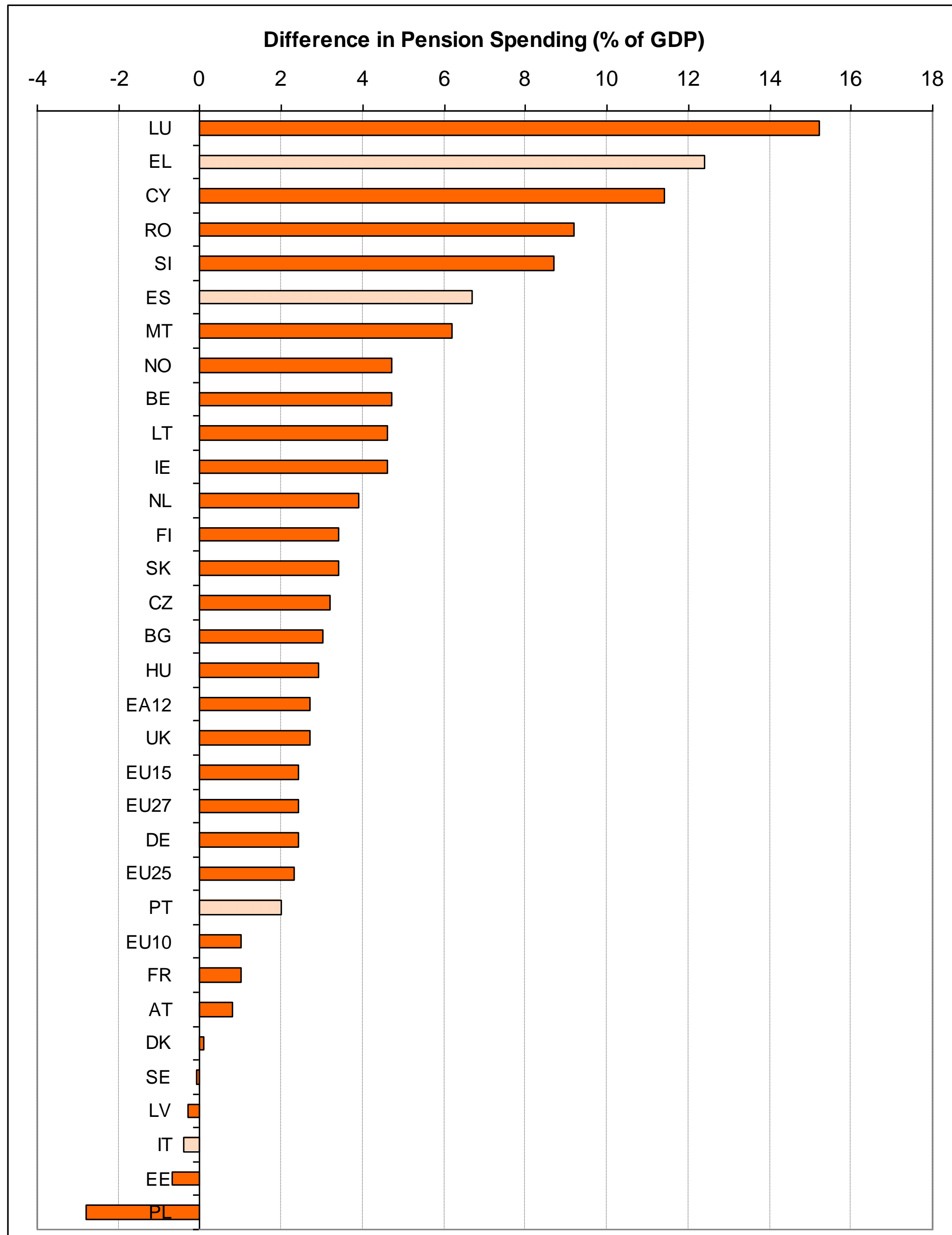


Source: Authors' elaboration upon data from Eurostat

Finally, in order to assess the situation of public pension systems at the start of the crisis, we present data on pension spending projections from the Social Protection Committee (SPC) of the European Commission. By looking at the difference in the

projected pension spending from 2007 to 2060, it is possible to observe which countries face more pressure to reform their pension system.

Figure 3: Difference in EPC Pension Spending Projections (2007-2050)



Source: EPC (2009)

The data clearly shows that Greece and Spain, with projected increases of 12.4 and 6.7 per cent of GDP, face a significant pressure to reform their systems. By contrast, Portugal boasts a moderately increase of 2 per cent, while Italy actually shows a decrease of 0.4 per cent of GDP. In both cases, this is explained by the structural reforms applied since 2005 in Portugal and since 1995 in Italy.

In sum, this section has showed that at the onset of the crisis Spain and Greece showed a combination of significantly deteriorating public finances together with pension systems in need of reform. The next section illustrates that the rush to implement cost-containment reforms has been more significant in Spain and Greece when compared to Italy and Portugal.

4. Country responses

4.1 Spain

In the beginning of 2010, the socialist PSOE government unveiled ambitious labour market reform plans aimed at making the labour market more flexible. The plan was approved in September 2010. More importantly, the government also unveiled plans to reform the pension system, proposing to increase the retirement age to 67 years of age and extend the years of contribution considered to calculate pension benefits from 15 to 25.

It is important to note that since the mid 1980s the public pension system, which has an unfunded Pay-as-you-go (PAYG) structure, has undergone different cost-containment reforms that explain much of its positive performance so far (cf. Carrera et al., 2010). Some of the most important reforms agreed since the mid 1990 have included the increase of the retirement age to 65 years, the calculation of retirement benefits using the last 15 years of contributions and a minimum requirement of 15 years of contributions to receive a pension. Most notably, one of the significant innovations of the late 1990s reforms has been the creation of a reserve fund with the surpluses of the system which

has reached a total of more than 60bn Euros (or 5.5 per cent of GDP) at the end of 2010 (Informe a las Cortes MTASS, 2009).

Notwithstanding the positive performance of the system in the early 2000s, it should be noted that the funding structure of the system was never changed; this means that the system is still highly vulnerable to a decline in employment levels. In addition, contrary to the recommendations of the parliamentary commission that in the mid 1990s set out specific recommendations to ensure the financial sustainability of the system, progress in eliminating generous arrangements for specific cohorts has been slow and, according to official estimates, more than 40 per cent of workers still retire before the normal retirement age of 65 years, which explains why the average retirement age is at 62.8 years (*ABC* 22nd August 2010).

The crisis and the subsequent increase in the unemployment rate have severely affected the level of contributions and the further sustainability of the system. As shown in Figure 2, unemployment has more than doubled in less than two years. In fact, official figures showed that the system lost almost one million contributors only from January 2008 to January 2009 (*ABC* 4th February 2010). Some specialists have therefore forecasted that without the implementation of further reforms the system will enter into deficit levels from 2014 and the reserve fund will be exhausted by 2023 (*El Pais* 9th May 2010).

In terms of the sustainability of the system, it is safe to assume that, if implemented correctly, the government proposal to increase the retirement age and the number of years used to calculate pension benefits will help to prevent the system from entering into deficit levels given the recent good performance of the system and the fact that the baby boomers will start retiring around 2015. However, this measure should be coupled with the elimination of pre-retirement arrangements.

The rush of the government to apply a significant reform can be understood by the specific combination of a crisis that has affected the economy harshly and a pension system that still maintains a very generous benefit structure, as evidenced by the EPC projections showed in Figure 3.

Whether the reforms will be able to address the adequacy of the benefits currently paid will depend on further measures. Current estimates from OECD show that the gross replacement rate of the system is around 81 per cent of average earnings (OECD, 2010). While this figure is sensibly higher than the 59 per cent average for all OECD countries, it should be noted that the distribution of wages in Spain is highly skewed. Thus, in 2008 it was estimated that while the median wage was 18,244.40 Euros, more than 17 per cent of wage earners reached a salary below 2/3 of that value (Instituto Nacional de Estadistica, 2009). This explains why the median pension paid by the system is of only 650 Euros (Estadisticas MTASS 2010). Therefore, to address the problem of adequacy, labour market reforms should be focused at tackling the great disparity in wages observed. In the meantime, specific reforms could include extending the number of years for the calculation of the pension benefit to the whole working career in order to include the early and mid career year contributions which, given the usual practice of displacing older workers to lower paid jobs or pre-retire them, tend to be higher than towards the end of their working career. Nonetheless, the prospect of a long period of low economic growth will have consequences on the value of future pension benefits.

4.2 Greece

In the Greek case the relationship between the crisis and its social protection system is two-way one; the inability to reform –among others- the Greek pension system has undoubtedly contributed to the fiscal crisis, while the crisis and the measures to tackle it have added further impetus to the need for reform (Matsaganis, 2010).

In terms of the former, while the need for reform has been repeatedly documented, the reform record has been modest if not low (Carrera et al, 2010; Featherstone & Papadimitriou 2008; Sakellaropoulos and Economou 2006). Initiatives implemented over the past two decades have been limited to parametric changes, providing the system with a "window of opportunity" until the next reform initiative. Against this background, it comes as no surprise that the Greek pension system is still faced with a series of

important challenges; Greece has one of the fastest ageing populations in Europe with the old-age dependency ratio expected to increase from 27.6% in 2007 to 57.0% in 2050 compared to 50.4% in EU/27 (EPC, 2009). As shown in Figure 3, pension spending is projected to rise by more than 12 per cent of GDP from 2007 to 2060, well above the EU average of 2.4 percent. At the same time, while Greece spends 12% GDP on public pensions, the risk of poverty –while declining- was 23% in 2007 compared to 16% for the EU/27 (Council EU, 2009) thereby raising issues of intra-generational equity, a paradox explained by the system's fragmentation (Borsch Supan &Tinios, 2001). The latest attempt to rationalize the system took place in 2008 with Law 3655/2008 "Administrative and Organizational Reform of the Social Security System" limiting the number of funds through merges and unifications from 175 to 13. The effectiveness of the reform has been questioned though both by the European Commission and the Greek Actuarial Authority, with the latter stressing that the measures foreseen did not result in the curtailment of bureaucracy or in ensuring the system's sustainability.

The revision, on the other hand, of the debt and deficit data by the Greek authorities following the October 2009 elections raised markets' concern about fiscal sustainability resulting in the increase of the spreads on Greek bonds and a lowering of credit ratings. The initial uncertainty related to the availability and modalities of financial assistance to Greece were finally surpassed as the Euro Group concurred with the Commission and the ECB that market access was insufficient for financing Greece's debt and therefore agreed on 2 May 2010 -following a joint EC-ECB-IMF mission sent to Athens to discuss a policy package to restore macroeconomic stability and sustainable long-term growth- to activate stability support.[2] Greece's economic policy program –monitored through 12 quarterly reviews- is supported with a €110 billion financing package provided by the euro area member states (€ 80 billion) and the IMF (€ 30 billion). The program includes both structural and fiscal reforms so as to help Greece overcome its deep-rooted structural deficiencies. The updated Stability Program sets 2012 as the date for reducing

[2] Before April 2010 the Greek government had not requested any financial support and consequently no decision was taken to activate the above-mentioned mechanism which was to be considered as ultima ratio, meaning that market financing was insufficient.

the deficit below the 3% reference value, while setting a target of 8.7% GDP for its 2010 budgetary deficit, representing a 4 percentage point reduction from the estimated 12.7% deficit for 2009 (IMF, 2010a).

The policy package had immediate effects on pensioners through the abolition of the 13th and 14th pension and their replacement by a flat-rate bonus of 800€/year for pensions below 2.500€/month, the introduction of a tax for pensions exceeding 1.400€/month and a freeze for all pensions over the next three years, yet it did not affect minimum pensions and family benefits.

More importantly, the Memorandum speeded up the reform process that had started in late 2009, through the establishment of an Experts Committee, as it laid down the basic traits of the new system. Law 3863/2010 was finally approved by the Greek Parliament on 12 July 2010. The basic innovative feature relates to the introduction of a "new architecture" through the separation of the assistance and insurance functions. In particular, from 2015 onwards pensions benefits will be composed of two parts; a basic (flat-rate) pension amounting to 360€ in 2010 prices, granted on a 12 month basis and a contributory one based on life-time earnings. The basic pension will also be awarded to uninsured over the age of 65 or with a contributory record of less than 15 years with individual and family income below 5.400,00 € and 10.800,00 € respectively and provided they have spent at least 15 years in Greece between the age of 15-65. Full pension is awarded for those fulfilling the above criteria and have resided in Greece for 35 years.

While the introduction of the basic pension can be interpreted as "path-breaking", i.e. by moving the system away from the Bismarckian tradition (Matsaganis, 2010), its level is set at a level below the poverty line thus raising questions about the extent at which it can guarantee an adequate income.[3] As argued by Matsaganis & Leventi (2010) "although its value was below the fiscally sustainable level of a hypothetical universal

[3] According to EU-SILC data having 2007 as reference year, the poverty threshold is set at 6,480€ on a yearly basis, or 540€ on a 12-month basis). The benefit is also below the 540€ mark proposed by the Government PASOK in its programme

basic pension paid to all residents aged 65+ […] given current fiscal difficulties and future demographic trends, this was probably inevitable”.

In the case of the contributory pension, the law foresees a uniform profile for accrual rates, while it raises the number of insurance years to 40. Pensions will be indexed to GDP and CPI growth however they cannot exceed the latter. In addition, from 2024 pension benefits will be adjusted to changes in life expectancy at the age of 65. The new law clearly tightens the link between contributions and benefits, yet it also provides for credits (being bought) for time spent away from the labor market for studies, military service, child birth and child rearing and unemployment. The introduction of credits seems to confirm with the point expressed in the EU Joint Report according to which “as work histories required for a full pension are being extended it is important to protect vulnerable groups from career breaks”; such elements –apart from the introduction of the basic pension- can be found through the introduction of credits. Concerns have been raised though as to the extent at which their acquisition is set a level prohibiting their claim.

On their first quarterly review mission of the Greek government’s economic program, staff teams from the EC, the ECB and the IMF welcomed Parliament’s approval of the landmark pension reform, considered as far-reaching by international standards (IMF, 2010b). As noted by the IMF (2010a:11) preliminary results indicate that the reform will reduce incremental pension spending substantially (perhaps by 6.5-8.5 per cent of GDP). However, such reduction falls short of the goal of bringing spending down by 10 percentage points over the period 2010-2060.

Overall, the Greek case shows how the combination of a significant effect of the crisis and the poor performance of the system has led to one of the most radical pension reforms ever implemented. However, the crisis has fallen short of providing the opportunity for a paradigmatic change through a move towards an NDC system as implemented in Italy during the 1990s. The reform can thus be considered drastic only in the sense of introducing significant cuts to current and future benefits.

4.3 Italy

As in the other countries in the region, the effect of the economic crisis on the Italian economy has been quite significant. As showed in the previous section, government budget deficit levels have increased as well as the unemployment rate, although both indicators are still far from the ones experienced by Greece and Spain.

Against the background of an economic recession, the Berlusconi government proposed in April 2010 an austerity package seeking to bring down the budget deficit below 3 percent of GDP by 2012 (Financial Times 25th May 2010). The package sought cuts amounting to 24 billion Euros. As explained by many observers and some members of the prime minister cabinet, the measures are addressed at regaining political support from investors who have started to worry about the government's capacity to repay its debt (*Il Sole 24 Ore*, 24th July 2010).

In the specific area of pensions, the measures consist of the following:

- Increasing the retirement age for women in the public sector progressively to 65 years by 2018. This follows a sentence from the European Court of Justice aiming at addressing discrimination. According to some estimates, this will save around 1.4bn Euro in the 2012-2018 period.
- From 2010, the dates in which the first pension payment is made for workers that fulfil the retirement requirement will be set at one year for the employed and one and a half year for the self-employed. This time-window, longer than the current six months, will entail savings of around 3.5 bn Euro in the next three years (*Il Secolo XXI*, 19th August 2010).
- More importantly, from 2015 the retirement age will be linked to life expectancy for those with less than 40 years of contributions. The effective retirement age will be revised every three years according to the life expectancy calculated by the Statistics Institute.

To understand the character of the measures implemented it is important to note the series of structural reforms that have been implemented since the mid and late 1990s (Natali

2004; Lapadula and Patriarca 1995). Trying to address a system that was on the brink of collapse, these reforms changed its structure by calculating pension benefits according to a formula that takes into account workers' full contribution record, life expectancy at retirement and the evolution of GDP growth. These changes have helped to limit public pensions spending at around 15 percent of GDP and, as shown in Figure 3, pension spending to 2060 is expected to decline as workers retire fully under the rules of the system.

Against this background, we can understand the measures of 2010 as a continuation of the 1990s reforms. Therefore, it is safe to argue that in Italy the full swing of the crisis has not rushed government to implement more radical changes because those changes have *already* been taking place since the early 1990s. The Italian case shows how in the presence of a system that has been performing well in the last years, there has been no need to implement a radical change as those proposed in Greece or Spain.

The reforms that have been implemented since the mid 1990s have helped to guarantee the system's financial sustainability. However, the reforms have had an impact in terms of benefit adequacy. In this sense, replacement rate projections from the EPC show a worrying decrease of 17 per cent for low earners when considering replacement rates levels in 2006 and in 2046. In fact, the EPC report highlights that the introduction of a strong link between contributions and benefits (as done in Italy) has the unwanted effect of a decrease in replacement rates for modest pensioners (Commission EC 2010: 18).

In sum, while Italy seems to have solved the problem of financial sustainability, there are significant concerns in terms of benefit adequacy. We posit that future policy debate will need to look at the situation of the less advantaged and contemplate how those workers with a "patchy" contribution career or that have exited the labor market to fulfil carer roles (such as women) may end up receiving a pension benefit that is not sufficient to cover their basic needs.

4.4 Portugal

Contrary to other countries, namely Greece and Spain, pension reform has not been a significant issue in Portugal since the onset of the crisis. This was confirmed by the Portuguese

Minister of Work and Solidarity, in an interview (*Jornal de Negócios,* 6th July 2010). Also the European commissar of social affaires, Lászlo Andor - during the presentation of the Pensions Green Paper (2010) conclusions on 7th July 2010 - seized the opportunity to praise the Portuguese case as an “example” of a significant reform that “was done before the crisis affected the country’s economy and it thus helped to strengthen public finances” (*Jornal de Negócios*, 8th July, 2010). In this sense the Minister of Work and Solidarity stressed that the Portuguese system is not under immediate pressure.

To understand why the Portuguese system seems to have performed well in the wake of the crisis, it is necessary to make reference to the series of reforms that have been implemented in 2005 and 2007 (Carrera et al 2010: 15). These reforms marked a significant departure from the previous status quo. The most significant aspect of the reforms was the introduction of a mechanism that, similarly to the Italian case, links future pension payments to life expectancy and full contribution records.

The effects of the reform in reducing future pension spending were notable. According to the Aging Working Group in 2006, Portugal was the country facing the higher risk of pension spending increase, since the estimation of age-related spending was the highest in the EU, where pensions were the main component (AWG, 2006: 12). However, after the 2007 reform, the 2009 AWG’s report put Portugal in a safe situation, under the EU mean (AWG, 2009: Fig. 6). In the 2006 report, the expenditure projections showed an increase from 11,1 percent of GDP in 2004 to 20,8 percent in 2050 (AWG, 2006: 71, 83). In 2009 the same publication showed an increase in pension expenditure of only 2,2 percent until 2060. These data provide evidence of a great success of Portuguese reformers in addressing the sustainability issue.

However the reform will imply a significant cut in pension benefits for new retirees due to the new formula that takes into account life expectancy and workers’ career contributions (ISSA, 2010). In an optimistic scenario that does not consider the effect of the recent crisis, the average replacement rate of the system will pass from 90,7 percent to 70,6 percent of average earnings before retirement (SPC, 2009: 83). For low income workers, the 2010 SPC projections show a decrease of 18 percent when comparing the replacement rate in 2006 and in 2046

(SPC 2009: 18). This highlights the need to address the consequences on the adequacy and equity dimension.

However, there is another side of the story, concerning the political process of reform discussion and implementation (Carrera et al., 2010). If "pensions are political dynamite" (Blackburn, 2002) the Portuguese case seems to provide evidence about the way to make a deep reform, avoid social tension, and, simultaneously, being recognized internationally as an example of "successful" reform. The success to reform the pension system, long considered one of the most conflictive issues in Portuguese politics, led to the re-election of the current government led by the PS (socialist) in the last elections held on 27th September 2009.

The Portuguese case shows how the combination of a crisis that has had a noticeable, yet more moderate effect on the economy than in Spain and Greece, and a system that underwent a significant cost-containment reform before the crisis, did not lead the government to propose more radical reforms. The only significant changes passed since the onset of the crisis were related to the public servants' scheme. In this sense, the Government decided to accelerate the convergence towards the new rules that already apply to private sector workers. The retirement age will be increased immediately to 62.5 years and it will reach 65 in 2012. In addition, public servants will be subject to the same penalization rules that apply for private sector workers (Ministério das Finanças e Administração Pública, 2010).

5. Discussion and conclusions

The first goal of this paper has been to provide new evidence on how to understand the impact of the recent economic crisis on Southern European countries and their pension systems. Following the insights from the political economy literature, we theorized that economic crisis per se is not enough to explain the content of the different reforms. Thus, we argued that the combination of a significant deterioration of economic indicators during the crisis and a poor performance of the public pension system may help to understand why some countries have rushed to implement significant reforms while others have implemented very limited measures.

The comparative evidence from Portugal, Spain, Italy and Greece seems to confirm our theoretical expectations. Greece and Spain underwent strong consumption and economic growth in the years previous to the crisis. However, as the crisis set in, both countries experienced a rapid increase in the unemployment rate (particularly in Spain) and in government budget deficit levels. This was coupled with a deteriorating situation in their pension systems. In Spain, the improvements of the previous ten years to ensure financial sustainability rapidly evaporated with the onset of the crisis and the rapid destruction of employment levels. Given that the system still guarantees relatively high replacement ratios, pension spending projections looked increasingly unsustainable and prompted the government to propose a raise in the retirement age and in the number of years used to calculate pension benefits. In Greece, the lack of cost-containment reforms in the past and the austerity measures implemented by the government to rein on public finances as financial markets reacted negatively to the government review on debt and deficit levels, also had an impact on the pension system. Therefore, the government has passed a package of measures that aim to reduce pension spending significantly by strengthening the link between contributions and benefits in the following years.

The economic crisis also affected Italy and Portugal, albeit in a more moderate way. More importantly, both countries had already undergone significant cost-containment reforms before the crisis took place. In Italy, the reforms of the mid 1990s and early 2000s changed the structure of the system towards one in which benefits are calculated according to workers' full contributions and life expectancy upon retirement. A similar mechanism was introduced in Portugal in 2005 and 2007, resulting in a significant fall in the future pension spending. Thus, it is safe to assume that in both countries the onset of the crisis did not lead to more significant pension reforms because the reforms had already been implemented in the years previous to the crisis.

A second goal of this paper has been to assess how the changes implemented in Southern European pension systems will affect the financial sustainability and the benefit adequacy dimensions. Table 4 below aims to compare the situation in each country and their impact in terms of sustainability and adequacy.

In terms of financial sustainability, the reforms in Greece aim to reduce pension spending significantly, by around 10 percentage points of GDP. However this will be achieved by strengthening the link between contributions and benefits and this will have an impact on the replacement rates of the system. Whereas the current rates are at around 100 per cent, we may expect a significant decline in them once actuarial estimates are calculated using the parameters introduced in the recent reform.

In Portugal, pension spending is set to decline significantly by 2060 to around 13 per cent of GDP. However, such reduction may also have an impact in benefit adequacy as the net replacement rate will fall from 90 per cent to 70 per cent of income before retirement. In addition, the lack of favourable taxation for supplementary private pension schemes raises concerns as to whether future retirees will be able to meet their needs.

The situation is similar in Italy, where the reforms implemented since the mid 1990s have also ensured the financial sustainability of the system, with pension spending estimated at 13.6 per cent of GDP by 2060. However there are also concerns in terms of benefit adequacy given that the replacement rate will hover around 70 per cent of income before retirement for an average worker.

Finally, in Spain the government has not provided official estimates of how much pension spending is expected to be reduced in the medium and long term thanks to the reforms currently being proposed. Given that the reforms contemplate to increase the number of years used to calculate pension benefits from 15 to 25, we may also expect a reduction in the replacement rate, which may also have an impact in the adequacy of benefits for future retirees.

In sum, the comparative analysis of how the recent crisis has affected southern European countries and their pension systems seems to indicate that significant reforms have been necessary when the negative effects of the crisis have been coupled with a poor performance of the public pension system. In addition, by adopting a multi-dimensional approach to assess the reforms in the four countries we have been able to show that improvements in financial sustainability may have been achieved at the expense of benefit adequacy. This indicates that substantial challenges still lie ahead and we therefore expect more policy debate in this area in the upcoming years.

Table 4: Comparing reforms

COUNTRY	REFORMS	INSTITUTIONAL FEATURES		SUSTAINABILITY		ADEQUACY		
	Before and after proposed reforms	Type of benefits	Age of retirement	Pension Spending 2060 (% GDP)	First system 'breakdown'	Replacement Rate (gross) [1]	Replacement Rate (net)	Favorable taxation
GREECE	Before	DB	65(M)/60(F) before 1993	24.1%		105%	115%	No
	After	DB				92.90%	108.10%	
	2010 reform		Min. 60 with 40 years of contributions	14.1%	2030			
PORTUGAL	Until 2006	DB	65	20,5 %	2010	74,8% (without upper limit)	90.70%	Yes
	After 2007	Mix DC/DB [2]	65 + Sustainability factor[3]	13.4%	2035	54,7% (without upper limit)	70.60%	Yes (but less generous)
SPAIN	Before	DB	65	15.1%		90%	95%	Yes
	After	DB	67 and elimination of early retirement					
ITALY	Before	DC	65	13.6%		70%	75%	Yes
	After	DC	Minimum 65. Increasing since 2015 according to life expectancy					

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