Nicholas C Garganas: The Greek experience

Speech by Mr Nicholas C Garganas, Governor of the Bank of Greece, at the Economist Conference on "Social security reform in Greece", Athens, 14 February 2008.

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I would like to thank the organisers of the Economist Conference on "Social security reform in Greece" for their invitation and for this opportunity to speak on the subject of the implications of ageing populations – a subject of great importance for many countries, especially for Greece.

A main accomplishment of social policies in the second half of the last century – at least in the case of advanced countries – is that being old is no longer considered synonymous with a low quality of life. That accomplishment has been made possible through the provision of public pensions. In Greece, of course, a significant proportion of pensions are still very low, but this can be considered a consequence of inefficiencies and weaknesses in the social security system as it stands at present.

Yet, as Europe's population ages, a demographic shift will take place in the next forty to fifty years that will pose significant challenges to the pension systems of our countries. The ageing of society will make it increasingly difficult to maintain an adequate level of public pensions for our older citizens. To provide an idea of the demographic changes that are expected to take place in the next forty to fifty years, consider the following projections with respect to Greece, issued by the European Union's Economic Policy Committee. These projections cover the period from 2005 to 2050.

- Projection number 1: here is some good news – people will live longer, so that the population comprised of ages 65 or above will increase by some 60 per cent.
- Projection number 2: low fertility rates will contribute to a decline of some 20 per cent in the working-age population, defined as ages 15 to 64.
- Putting these two projections together means that the ratio of the elderly population to the working age population – what is known as the *old-age dependency ratio* – is expected to more than double between 2005 and 2050, reaching more than 60 per cent. This would mean that while there are currently more than three workers for each pensioner, in 2050 there would be only 1.6 workers per pensioner.

Thus, Greece, like many other European countries, will be confronted with a sharp rise in the old age dependency ratio. This situation, in and of itself, however, need not put pressure on the financing of the country's pension system. In particular, if the proportion of the population of working age that is employed were to rise, this rise could help offset some of the fall in the working-age population. Unfortunately, even here the news is not favourable. The employment rate is projected to rise modestly, but not enough to raise the level of employment. In fact, the level of employment is projected to decline by some 13 per cent between 2005 and 2050.

To sum up what I have said so far, thanks to advances in health care, people will be living longer, so that there will be a large increase in the proportion of the population aged 65 or more in the years ahead. At the same time, there will be fewer people of working age and fewer people actually working.

What, then, are the implications of these demographic projections? For one thing, they imply a sharp fall in Greece's potential GDP growth, perhaps more than halving potential growth between now and the 2030s and 2040s. With more people, and fewer producing goods and services, there will be less output for each of our citizens.

For another thing, the projections, if realised, would put enormous strains on our public finances. To give you an indication of the magnitude of these strains, according to projections prepared in 2002, pension expenditures in Greece will rise from 12.4% of GDP in 2005 to 22.6% of GDP in 2050, i.e. by 10.2 percentage points of GDP. The net increase in total old age-related expenditure (excluding spending on long-term care, for which no official figures are available) is projected to be 11.5 percentage points of GDP, reaching 32.7% of GDP in 2050. This situation compares with rises in pension expenditures of slightly more than two percentage points of GDP in both the EU25 and the EU15 over the same period, reflecting the implementation of important pension reforms in many of these countries since the 1990s.

Consideration of this set of facts yields the conclusion that pension reforms, public expenditure, employment, and growth are interdependent. Pensions constitute a major share of public expenditure and that share is projected to rise sharply in the years ahead. Moreover, pension systems and labour-market performance have close ties, and these ties have important implications for economic growth. Pension systems embed incentives that affect the labour supply of, and demand for, mature workers, while a high level of employment also ensures high levels of contributions into the system and contributes to the productive capacity of the economy.

My discussion has so far focused on the implications of an ageing population for Greece's projected public expenditures. There is, however, another dimension with respect to the public finances that warrants attention – the implications of population ageing for the *sustainability* of the public finances. These implications are especially unfavourable for Greece in the light of the country's high debt-to-GDP ratio, which is the second highest in the EU. In this connection, European Commission projections of the general government debt-to-GDP ratio for Greece indicate that this ratio will more than triple between 2005 and 2050, reaching 346%, though the ratio would be somewhat lower if the recent GDP revision were taken into account.

Clearly, there is need of a comprehensive set of policies to change demographic prospects, enhance employment and its productivity through reform of the product and labour markets, reform the pension and healthcare systems, and pursue sustained fiscal consolidation.

A number of measures can help boost employment rates. Female participation rates could be increased by increasing child-support and making working-time arrangements more flexible. The latter measure would also attract more younger workers into the labour force.

Another type of measure that directly confronts the problem posed by an ageing population concerns the retirement age, which might be postponed on a voluntary basis. In other words, workers could be given a choice of continuing to work, even on reaching minimum retirement age. They may want to do so if the pension gain from staying longer in the workforce exceeded the cumulative pension lost from retiring later.

In addition, greater labour productivity growth in the long run should be achievable through accelerated structural reforms in the product and labour markets, increased productive investment in physical capital, and the upgrading of human capital.

The projected very large increase in Greek pension expenditures over the long term – much larger than in most other EU countries – clearly suggests that, in the absence of an early and major pension reform, fiscal consolidation measures by themselves – for example, tax increases or reductions in non-pension public spending – would not be sufficient to eliminate the projected budgetary imbalances without jeopardising the provision of essential public services. Pension reforms should aim to ensure the long-term viability of the public pension system, which should nevertheless continue to function as an important social safety net.

Finally, the sooner the fiscal consolidation is undertaken and the reforms are implemented, the better, for both fiscal sustainability and for long-term growth. The primary fiscal surplus required to stabilise public debt on a sustainable basis is significantly higher in the long run than in an early adjustment scenario. Moreover, delayed adjustment entails lower economic growth because of increasing crowding out effects and the economic disincentives stemming from rising taxes.

I began my speech by referring to the remarkable achievement of the second half of the last century whereby public pensions have greatly improved the quality of life of our older citizens. A return to a situation – or, in the case of Greece, the persistence of a situation – in which older people are poor or dependent on others is unacceptable. As people come to live longer they should expect that the quality of their lives during retirement years will be gratifying. Unless pension reform is implemented – and soon – population ageing will have severe economic consequences, including fiscal consequences. There is, however, light at the end of the tunnel. Some countries, as we have seen, have already implemented reforms, and their examples can help show the way for others. The aim of reforms is to provide a better standard of living for all of our citizens, not just for today, but for tomorrow as well.

Ladies and gentlemen, thank you for your attention.