

## Reform of Severance Pay Law Statements and Comments

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### 1. The Greek labour market and the system of severance payments

The Greek labour market exhibits certain peculiarities in relation to the other EU member states. The share of employment in agriculture continues to remain at relatively high levels and a sizeable segment of the labour force is self-employed. Production in the private sector of the economy is organised along the lines of very small enterprises, often managed by members of the same family. Labour mobility, both geographical and occupational is extremely low. Lastly for cultural, among other, reasons female labour force participation rates are low.

The overall employment rate in 2005 in Greece lagged behind EU average by 3.7 percentage points (60.1 per cent compared to 63.8 per cent). The parity was exclusively due to low female employment rates (46.1 per cent in relation to 56.3 per cent). In contrast, the employment rate of males exceeds the equivalent for EU by almost three percentage points (74.2 per cent compared to 71.3 per cent). The total employment rate of older workers in Greece is lower than the EU average (41.6 per cent compared to 42.5 per cent). Again, older males exhibit employment rates higher than EU average (58.8 per cent compared to 51.8 per cent) and older females much lower rates (25.8 per cent compared to 33.7 per cent). During 2005 total employment increased by 0.9 percentage points, a clearly positive development.

Unemployment on the other hand, affects 9.8 per cent of the labour force (2005), with women facing much higher rates (15.3 per cent) than men (6.1 per cent). Compared to EU, overall unemployment in Greece is higher than the EU average (8.7 per cent), male unemployment is well below EU average (7.9 per cent) and female unemployment is far above average (9.8 per cent). The youth unemployment ratio in 2005 was 8.8 per cent, not significantly higher than the EU-25 average (8.4 per cent). The unemployment ratio for young girls however, exceeded that of EU-25 by a considerable margin (10.6 per cent in relation to 7.9 per cent). Lastly, long-term unemployment is estimated at 5.1 per cent, comparing unfavourably with the EU average of 3.9 per cent. LTU is more pronounced among women, than among men (8.9 per cent in relation to 2.6 per cent). In relation to 2004, there has been an improvement of the situation as the unemployment rate decreased by 0.7 percentage points

Greece is one of the countries where dismissal of individuals faces restrictions. The basic laws governing the termination of contracts date from as back as the twenties, and have so far remained largely intact (Laws 2112/1920 and 3198/1955)<sup>15</sup>. In general, the restrictions imposed seek to protect the interest of workers and minimize the consequences from the termination of employment. The restrictions include the following: a/ written notice to employee, plus additional

<sup>15</sup> See, Yannakourou S., 2005, 'The evolution of Labour Law in Greece' in European Commission, 2005, *The Evolution of Labour Law 1992-2003*, Volume 2, Luxembourg.

notification to OAED local office (public employment service). Previous warning in case of dismissal for personal reasons may be advisable. Letter sent by mail or handed directly to employee, b/ the payment of severance pay and c/ the prohibition of dismissal of trade unionists, female workers during pregnancy and for one year after childbirth, workers during their annual leave, etc.

Severance payments vary according to length of service and according to the status of the employee. A basic distinction as regards the amount of compensation relates to whether the employee is a white collar or a blue collar worker. White collar workers are entitled to higher severance pay than blue collar ones. Further, only white collar personnel must be notified in advance. It should be noted that it is hard to justify this distinction between the two segments of the labour force. On the ground of fairness, any differential treatment between wage (blue-collar) and salary (white-collar) earners ought to be abolished. Severance pay applies only when an employee has been working for a company for at least two months.

Table 1 summarizes the conditions prevailing as regards the amount of compensation and the advance notice requirements for both white and blue collar workers in 2003<sup>16</sup>. With respect to changes over the recent years, severance payments and notice requirements were reduced in 1990, following Law 1989 amending Law 3198/1955 and raised slightly by the 2003 National General Collective Labour Agreement. More recently, the compensation levels for blue collar workers were modestly raised in the context of the 2004-2005 National General Collective Labour Agreement. The new provisions are shown in Table 2.

With respect to the level of severance pay and its implications on labour force mobility and flexibility among enterprises, very little are known. It is possible that the amount employers have to pay as compensation for an individual dismissal may restrict dismissals to some extent and conversely reduce the propensity of new hires, but this will have to be substantiated by empirical research.

Although however the issue of severance pay has not been a subject for discussion between the social partners and the government, OECD has repeatedly recommended that the high severance costs for white-collar workers should be brought more in line with those for blue-collar workers.<sup>17</sup> According to OECD officials, the index of Employment Protection Legislation (EPL) in Greece is at relatively high levels, comparing unfavourably with the great majority of the remaining EU member states. Total EPL (2003) is estimated at 2.90 (on a scale of 0-6), and this is the third highest value of the indicator recorded among 18 member states for which comparable data exist, following Spain and Portugal.<sup>18</sup> It is thus thought that the strictness of employment protection legislation, in conjunction with limited wage flexibility and high non-wage costs, may have contributed to low labour turnover and to persistently high unemployment rates for women and youth.

According to another international organization, the World Bank, firing costs in Greece are substantial and compare unfavourably with the average for OECD member states<sup>19</sup>. In 2006,

<sup>16</sup> EIRO, Thematic feature- redundancies and redundancy costs. Available at: <http://www.eiro.eurofound.eu.int/2003/11/tfeature/gr0311104t.html>

<sup>17</sup> OECD, Economic survey of Greece 2005, Paris

<sup>18</sup> It should be noted that the EPL indicator is a composite index, centering around restrictions on dismissals. See, OECD Employment Outlook 2004

<sup>19</sup> See, The World Bank Group, Doing Business. Available at: <http://www.doingbusiness.org/>

firing costs, expressed as weeks of wages and calculated for 20 years of tenure, were 69.3 weeks (OECD average 31.3 weeks). The difficulty of firing index was also found to be higher in Greece in relation to the other OECD countries (50 as against 27.4). In terms of international comparison therefore, Greece is among the countries with high severance payments.

Severance payments may also be a factor behind undeclared work, provided that the cost of dismissing people on permanent contracts constitutes an incentive for employers to resort to this type of work. Undeclared work is quite widespread in Greece, and in spite of efforts, it continues to grow in volume. If this hypothesis is correct, then lowering of severance pay is bound to reduce undeclared employment.

The government has shown no intention so far to change existing rules, delegating the issue to the social partners. The latter have generally treated the issue as one of secondary importance, focusing instead on other priorities (notably on pay rises).

**TABLE 1**  
**Severance pay and notice periods, 2003**

Length of service with the same employer	Compensation	Advance notice
A. White-collar workers		
From 2 months to 1 year	1 month	1 month
From 1 year to 4 years	2 months	2 months
From 4 years to 6 years	3 months	3 months
From 6 to 8 years	4 months	4 months
From 8 to 10 years	5 months	5 months
From 10 to 11 years	6 months	6 months
From 11 to 12 years	7 months	7 months
From 12 to 13 years	8 months	8 months
Rising to:		
28 years or more	24 months	24 months
B. Blue-collar workers		
From 2 months to 1 year	5 days	-
From 1 year to 2 years	7 days	-
From 2 years to 5 years	15 days	-
From 5 to 10 years	30 days	-
From 15 to 20 years	90 days	-
20 years or more	105 days	-

**TABLE 2**  
**New provisions on blue-collar workers' severance pay, 2004**

New regulations		Old regulations	
Years of service	Amount of severance pay	Years of service	Amount of severance pay
15	100 days	15-20	95 days
20	120 days	20-25	115 days
25	145 days	25-30	135 days
30 or more	165 days	30 or more	150 days

## 2. Potential Transferability

In contrast with the radical reform of the system of severance pay which occurred in Austria, Greece attempted only minor changes to the rules, tightening (as in the nineties) or relaxing (as in the latest collective agreement) criteria. It is understood that the main advantages of the new system for the employers is the suppression of the specific monetary cost of a dismissal, while for employees the cost of mobility is reduced. Other important elements of the new policy include the extension of coverage, lower average payments and the possibility of strengthening the funded pillar of the pension system. These features are discussed below in the context of the Greek labour market.

Labour mobility is very limited in Greece. In 2000, the share of employees with more than two years of job tenure was 84.3%, the highest share recorded among EU 15<sup>20</sup>. In the absence of relevant studies, one can only speculate on the effect of the severance payment system on mobility. Judging however by the amounts of money involved, the impact is bound to be a modest one. Other factors that have occasionally been blamed for the limited mobility seem to carry a lot more weight in explaining the observed trends. These factors include the high share of home ownership (in excess of 80%, among the highest in the Community), the high wage premiums associated with job tenure and the fragmentation of the social security system (plethora of funds often operating with different rules) inhibiting occupational mobility.

Another feature of the new system is that it raises labour costs. In Greece, the level of non-wage costs is higher than the EU average. Social security contributions remain high, accounting in 2004 for more than 34% of total gross labour costs, compared with an EU average of around 31%. The high non-wage costs have been identified as one of the most influential factors impeding new hires. Indeed, the lowering of the cost of social security contributions, through subsidization, has been the object of a recent legislative initiative. Law 3227/2004, titled 'Measures for the remedy of unemployment and other provisions', introduced a variety of provisions, including: the subsidization of employer's social security contributions for hiring unemployment women with at least two children; the subsidization of social security contributions payable by an employer who hires employees on a temporary contract to replace employees on maternity leave; the exemption from the payment of social security contributions of women working as farmers for one year after the birth of their second child; the subsidization of 50% of

<sup>20</sup> See, European Commission, Employment in Europe 2001

the employer's insurance contribution for employers who hire unemployed youths (up to 25 years old), or unemployed people aged 55 and over, who have at least 6000 daily insurance stamps. Law 3227 has so far remained inactive, because of the financial cost it entailed. According to media sources, the Ministry of Employment is planning to restrict the application of the law in areas of high unemployment. In any case, an additional increase of the labour costs would only tend to restrict new hires.

As regards the finding according to which the new system generates lower average amounts in relation to the previous one, it is evident that the level of severance pay must be discussed in conjunction with the generosity of unemployment benefit system. This is because one of the basic functions of the severance pay is to provide income support (social benefit). The Greek system of unemployment benefits has often been criticized for being ungenerous, judged by European standards, and also inequitable. The net income replacement rate (an indicator showing the proportion of in-work income that is maintained for someone becoming unemployed), is 66.89% in Greece during the first year of unemployment (2003), not much different from the equivalent rates recorded for the other member states. This indicates that unemployment benefits do not discourage job search in Greece. But for benefits sufficiency, the duration of benefits is also important. Estimates of NRR after 5 years indicate that these drop to negligible levels (1.75%), the lowest NRR recorded for the EU countries for which data exist, with the exception of Italy, reflecting the limited duration of support. Furthermore, large categories of the labour force (e.g. the selfemployed) and of the unemployed (new entrants in the labour market) are practically left without coverage.

The government has recently announced changes in the level of regular unemployment benefits. Following these changes, the unemployment benefit will increase from 311, 25 Euros presently, to 349, 50 Euros on the 1<sup>st</sup> of January 2007 and from there on to 367, 50 Euros on the 1<sup>st</sup> of May 2007 and to 404 Euros on the 1<sup>st</sup> of January 2008. On a daily base, the unemployment benefit will correspond to 13, 98 Euros (instead of 12, 45 Euros today) to be increased to 16, 16 Euros on the 1<sup>st</sup> of January 2008. In all, unemployment benefits will increase by 29, 80%, and in 2008 will correspond to 55% of the minimum daily wage agreed by the National General Collective Agreement. From 2008 onwards, the level of the unemployment benefit will be indexed to take account of the pay increases agreed in collective agreements. The planned increase of the unemployment benefits has been long overdue, as the level of benefits has not been adjusted during the last two years (and this in spite of Law 2224/1994, according to which the level of the unemployment benefit should correspond to 66% of the minimum daily wage). Further actions are needed however to extend the coverage, level and duration of unemployment benefits and until such changes occur it would seem unwise to lower the level of severance pay.

With respect to effects on the pension system, there is currently a public debate in Greece on the future of the social security system, covering the whole spectrum of issues (retirement age limits, level of social security contributions, reshaping of the pension funds and the restriction of tax evasion). The Greek social security system is very fragmented, reflecting a history of piecemeal evolution. Membership and insurance rules vary substantially. Despite consolidation in the 1990s, there are still 173 social security funds. Of these, 24 are primary funds that provide the main pension, and 124 are supplementary, lump sum, and provident funds. In addition to pensions, most primary funds also provide health cover, or provide it through another fund. Some funds provide additional benefits, like family benefits. As regards the financial state of the pension system, the most recent comprehensive study was carried out around 2000 on the basis of 1998 data, and formed the background for the Greek report on the costs of aging to the European

Commission in 2001. The 2001 projections estimated that pension expenditures would increase by 12.2 percent of GDP, from 12.6 percent of GDP in 2000 to 24.8 percent of GDP in 2050. The analysis showed that only very optimistic macroeconomic developments or fairly drastic changes to the pension parameters would significantly reduce this very large pension deficit. In conclusion, the longer term viability of the pension system is one of the biggest challenges facing policy planners and introducing new elements such as supplementary occupational pensions at this stage would only complicate further an already complex situation.

For the reasons stated above, it would be hard to maintain that Greece could substitute the existing system of severance pay with a new one, along the lines of the Austrian experience. In the absence of changes in unemployment provision, any reform entailing lower severance pay will be fiercely resisted by the trade unions. Admittedly, the new system facilitates labour mobility and Greece could gain from increased labour turnover. But in times of high and persistent youth unemployment (as in Greece currently), increased mobility may hold gains and losses for different demographic groups. For certain categories of the workforce, such as older workers and the low-skilled, increased mobility may entail risks and these will have to be studied carefully prior to changes.

Finally, one of the elements of the new system, namely the extension of coverage to all, needs attention. In Greece as in elsewhere voluntary withdrawals are not covered by severance payments. The latter are only applicable to dismissals<sup>21</sup>. In the real world however, the boundaries between quits and dismissals are often blurred. Although there are no studies to substantiate it, in Greece it is common knowledge that a portion of those quitting their job do so out of pressure (involuntarily) rather than out of free choice. It is also possible that some of the contracts terminated as dismissals represent in reality voluntary withdrawals. This situation may occur in cases where the employer may feel obliged to help the former employee claim unemployment benefits. For reasons of fairness therefore it would be advisable to extend coverage of severance pay to all, irrespective of the reasons behind the termination of their contracts.

### 3. Important issues

The new system of severance payments is definitely innovative and as such it deserves our attention. Clearly more research is needed however to observe the effects over a longer term horizon. This is because radical reforms often tend to produce side effects, some of which may be non-intended and difficult to predict in advance. In addition, the labour market is a dynamic space and some of the policies that work well in periods of low unemployment may cause different effects in periods of high unemployment.

The distributional effects of the higher mobility induced by the new policy (provided that the new system increases mobility) need also to be studied further. Increased mobility may hold gains and losses for different demographic groups. Limited mobility tends to reduce the employment rate of both first-time entrants (mainly young people) and prime-age women. At the other end of the scale however, those in the core labour market (mainly men aged 25-54, heads of households) may

<sup>21</sup> In 2005, dismissals involved 674.648 persons and voluntary quits 388.561 persons. Source: Bank of Greece, Bulletin of Conjunctural Indicators, Number 97, August 2006.

benefit from lack of labour mobility. Thus for certain categories of the workforce, such as older workers and the low-skilled, increased mobility may entail risks.

