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Anomalies in Flexible Retirement

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Abstract

These days we have experiences about the basic crisis of the pension systems and mainly old-age pension systems. The states try to minimize the obligations taken from the families and it is justified by the difficulties of financing. On international level the ILO Convention No. 102 decrees the possibility of flexible retiring for the member states which take the obligations, but it is contrary to this „withdrawal”. The aim of my examination is to analyse the flexible pension from different points of view and to justify its necessity and to describe the criteria of flexible pension, its possible fulfilments, furthermore, which social, demographic, administrative – financial, fundamental right questions influence it, and how should its role be interpreted in the co-ordinating system of supplying/servicing systems defined by social law.

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1. Introduction

The analysis of pension systems offers several angles, depending on the field of study we work in. A basic and general approach is the review of the sustainability of the pension system, which again opens further options: economics tends to analyze the financing of the system and the impact of demography, yet from the perspective of law, it is crucial to emphasize fundamental rights security and the effects of pension systems on the whole of legal systems, the effects on fundamental rights and its interaction with the whole legal system is crucial.

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2. The evaluation of flexible retirement

The assessment of flexible retirement largely depends on what or whose interests are considered when analyzing it. Seen from the end of financing and funding the system, flexible retirement can be advantageous for the system as early retirees earned lower benefits, thus the costs are also lower. This advantage, however, is insignificant in comparison to the comprehensive load early retirement puts on the system, mainly arising from longer life-expectancy. Looking from the point of the contributors, who are future beneficiaries, the equation of costs and benefits, is reversed: lower benefits might be a favorable option at an earlier age and might lead to a willingness to pay higher contributions. This alone underlines the importance of an efficiency-study before any decision is made on the flexibility of the pension system. A detailed discussion of all the aspects of this exceeds the limits of the legal profession therefore I will not pursue such ambitions here. In my opinion, the issues should also be discussed within the frameworks of other legal regulations and regulatory systems in social rights.

When drawing up the regulatory system, the first issue that should be addressed is the definition of flexible retirement. Is it the flexible handling of retirement age in a retirement scheme? Or can the alternative ways at alternative ages be also considered as flexible retirement? To reaching retirement status at various age make up flexible retirement? I suggest the application of a broader approach here, since several labor law or employment policy measures may affect the flexibility of a pension system. The interaction between employment policy and the pension system can be studied from several aspects. The quality of the labor market and the list of pension benefits are closely related. Even without any major crisis in the labor market employment rate has a significant impact on the pension system, as the safety of jobs for older employees is deeply influenced by over-supply on the labor market. It correlates with the fact that a large part of unemployed people in a disadvantageous situation belong to the age group before retirement, particularly those with a lower level of education and doing physical work. In gloomier times on the labor market the situation becomes even more intricate as employees with unstable job-status tend to seek a more reliable and long-term income, like pension benefits. These phenomena occur at times of structural changes in employment or in periods of economic recession. Good illustrations of these developments were visible in the early 1990s in Hungary, but the developments after 2009 are also relevant: the rate of early retirement and disability pensioners surged. Handling these issues is a governmental task: either support such developments, as in the 1990s, or counter them, as in today's Hungary.

This is the point where the legal aspects of social protection link to economic and employment policy regulations. In the early 1990s the Hungarian government sought to provide social security for older people who dropped out of the labor market by facilitating their entry into the pension system, thereby preserving employment policies from such demands. Hence, the instrument of early retirement plan was introduced, creating a half employment policy-based, half pension-based answer to the issue. This also served as an alternative option to lay-offs. The employer – in agreement with the state – could opt for paying pension benefits to the early retiree instead of paying the severance pays and benefits. The advantage of this construction was mutual: there were no further costs for the state pension system, and unburdened the employment policies in a way that was beneficial for both, employer and employee. The instrument of early retirement plans came in several forms: early retirement (age benefit), early retirement with lower benefits (age and contribution time benefit), general and profession-related age benefits (age benefit with multiple contribution time benefit).

At the time of the economic recession and during the developments from 2009 these advantageous retirement plans were rolled back and/or abolished. Beyond the unfavorable labor market situation demography changes also played a role: with a lower birth rate a larger number of active employees reached retirement age. In order to cut back pension costs first several benefits were revoked, later retirement age was raised as a precautionary measure. The abolishment of benefits not just put further load on the already strained labor market, but it also thwarted the spread of flexible retirement.

Besides the labor market, through demographic effects, the family support system is also closely linked to the state of the pension system. It is obvious that birth rate affects the pension system through the demographic tree: with a changing number of children the rate of dependants evidently changes. Following this line of thought it is easy to understand that family policies aiming to increase birth rate are also indirectly related to pension systems. Tax policies and family benefits intending to increase the birth rate are however not devised and passed with the pension system in hindsight, rather the demands of the society and the state. But the upshots of these policies have

an indispensably significant effect on the pension system. Some economic analyses consider both family support systems and pension systems as equal burden for the active employees, as these both work for the inactive, dependant cluster. So they act as a long-term burden for active wage-earners. Some models suggest that the increase of birth rate, ie. population getting younger, - in terms of costs for the society -- correlates with the increase of the number and costs of pensioners (ageing population). Still, society supports and is motivated to increase birth rate. New pension system would plans interlink these dependant, inactive clusters by making contribution to the pension plans dependent on the number of raised children. These models either plan to raise contribution for those without children, or would introduce child-based reduction in the contribution. Roots of these plans are in the tax policies of states with lower birth rates. Models thus suggest adaptation of such policies to pension systems.

3. The international level

On the international level the conditions of flexible retirement (plans) are stipulated in ILO's Convention No. 102. Flexible retirement is primarily defined as the relative flexibility of pension systems, which means the convention merely sets up frameworks. It sets 65 as the maximum age in retirement, yet leaves room for longer work years and appropriate regulations. Further, it allows the proportionalization of pension payments in case of working as a pensioner. (*Article 26., Convention 102.*) The convention requires the states to set preconditions for retirement in a way that renders at least 50 percent of all employees protected or formulate the economically active group of people so that it makes up 20 percent of the entire population. (*Article 27., Convention 102.*) This affects the conditions for flexible retirement. The convention allows that states can couple eligibility to contribution time and residency, also, reduced benefits are allowed. In case of the combination of these prerequisites the states can draw up diverse regulations and with that enable flexible retirement.

These goals were also acknowledged in the European Social Charter and the Revised European Social Charter, particularly in the right to social insurance. Within this framework the charter – stepping up from the ILO Convention No. 102., and the European Social Security Codex – the states oblige themselves to constantly improve their respective social insurance system. In my opinion, the improvement of social insurance systems should manifest in social wellbeing, thereby meeting the demands and requirements of customers, namely the active employees approaching retirement age. (*Article 12, The right to social security*) These demands mainly focus on longer active years in retirement and adequate benefits and supplies for these years. Both demands are subjective and only a flexible retirement plan (scheme) can fulfill them. Meeting international standards and obligations is just one factor in satisfying these demands, a more crucial aspect is to raise the willingness and commitment to pay contribution in the active years and thus to achieve a higher level of appreciation of the social insurance system.

This is the point where economic and demographic analyses are inevitable to properly outline the boundaries of a system, i.e. to find the elements that strike the right balance between cost and benefit and at the same time to meet the obligations stemming from social rights. Various theories embrace different approaches to explaining the role of social insurance systems. The positive theory approach to social security tallies the features that are distinctive to social security systems in general. Elements of such systems are defined to be luxury items in the operation of the state that are – in forms of provisions - attributed to work. Based on this assessment social security could be a guarantee for sustaining efficiency. Xavier Sala-i Martin (1995) claims that it does not necessarily cause anomaly, if the state forbids or heavily taxes working in retirement, while does not levy tax on or even positively discriminates non-work-related incomes. He argues that social security system should serve as backup for employers to discharge inefficient employees in order to maintain efficient production and economic development (Sala-I-Martin, 1995). In my view, this means that society, state and the economy are all interested in the optimalization of the social insurance systems.

4. The economic concepts

Several economic concepts have been drawn up that aim to drive social insurance and pension systems out of it current crisis. These involve various approaches to examine and reform social insurance systems, especially pension systems that are of outstanding importance in terms of social supplies and maintenance. The goal of the reviews is to assess and gauge efficiency, accuracy, stability and reliability and to eliminate defaults (Alács, 2004).

Making pension systems flexible would also avail an even more ideal coverage of the beneficiaries, while avoiding overflows in funding. One basic model focusing on active workers with income finds an answer to the issue in the connection between income clearance and pension benefits. Based on this, there are two extremes of pension-types: the employment-based pension, in which the monthly pension provision is based on the income/contribution received/paid during the active employment period, and the social pension. Employment-based pensions, also called retirement plans are based on various patterns of the active employment period, while at the same time the insurance variables are also introduced to the calculation to estimate an ideal age of retirement and proper amount of pension benefits (Simonovits, 2000). A great advantage of this model is that it drives the employee towards making retirement savings proportional to the actual income. The German and Swedish examples best illustrate this model (Simonovits, 2008). The ground for the existence of social pension is that it considers social aspects and moderates old-age impoverishment. The Czech and Irish models represent this approach. Simonovits (2006) Of course, several mixed models exist: these combine employment-based pension patterns with social pension elements in one system. (Martos, 1994; Disney, 2004). The best example for the mixed model that comes closest to the ideal is the two-tier model that Switzerland runs: the tax-funded first pillar provides a certain level of basic benefit for everyone, while the corporate-financed second pillar is a private pension that is calculated on the basis of income (contribution). The British model further differentiates the first pillar by introducing need-based, supplementary benefits beyond the basic benefit (Simonovits, 2008). The British system is therefore more complex and differentiated than any other in Western Europe (Bíró – Nádas – Rab – Prugberger, 2004). Basic pension thus serves to introduce the solidarity features derived from social right, while employment-based pensions – the pure income (contribution)-based in particular – are deemed as purchased benefits with contractual obligations that are legally secured even beyond the constitutional protection.

In the Hungarian trade-literature the theory of Simonovits and Augusztinovics (2005) on basic- and need-based pensions are the foundations of further discussions the subject. International economic research has come to a similar conclusion to Simonovits' on need-based pensions (Simonovits, 2006; Augusztinovics, 2005) The subject of basic- and need-based pensions was first studied by Friedmann and Cohen in 1972. At that time it was seen as a possible instrument to lower costs and replace universal coverage Friedmann-Cohen (1972).

Feldstein reviewed the American pension system considering individual gains and social well-being and concluded that social elements of the pension system should be reduced to a minimum, otherwise contributors remain disinterested in making higher savings Feldstein (1987). Consequently, if the social elements are too lavish, basic pension benefits seem more efficient than social benefits.

If the drive to make pension systems more flexible does not meet the demands of the beneficiaries - and it should be admitted that neither social insurance systems, nor the states maintaining these systems are prone to act this way – then reforms are only acceptable for the public, if legal guarantees are offered. In this sense, the introduction of the institutional protection of the pension system is inevitable to achieve the support of the society. This is feasible through the self-constraint of the state, like in Norway and the UK. Gál (2007) Again, this cannot be expected in every state, not even in Hungary, therefore elements that limit the latitude of governments and guarantee legal security should be introduced to the systems.

5. Role of the social rights

Social rights serve as the foundations to grant access to social security, which guarantee membership in (national, state-operated) pension plans and a certain level of pension benefits. The extent and scope of social rights heavily depend on the interest-representation capabilities of the stakeholders, both on national and international levels. The limitation of this interest-representation is necessary also from an ideological point of view, as the scope of the social rights should not exclusively rest on lobbying qualities. Sári (1999) Spontaneous interest-representation may lead to the devaluation of these rights by the phenomenon that the rights of those with smaller lobbying-power would eventually become smaller in extent. That is the reason why the state should legally commit itself to the protection and guarantee of social rights in the Fundamental Law.

Further, it should not be ignored that a more tangible and manifest expression of social rights in the Fundamental Law could – in case of economic downturn - lead the state to walk back on the level of social provisions, which compels the state to make restrictive modification of the constitution, which again means the depreciation of the

Fundamental Law. Balogh (2005) The strongest case for pinning social rights as basic rights is that the international legal environment that created them also does the same way. Evading to follow suit in this regard would render internal legislation incongruent (incompatible) with international law.

In case of the crisis of the welfare state, social rights emerge as impediments and checks on reforms and reduction of social benefits. Kardos (2003) claims that the protection of social rights is an important cornerstone for the future development of democracies. The questions arise: to what extent should modern demand to meet individual demands restrict the market, will social inequalities upset political equalities, how can social disruption be relieved under the circumstances of globalization (Kardos, 2003) The flexibility or inflexibility of pension systems is closely related to observing social rights. The level of legal security and protection are defined by the constitutional instances of a state and the legal protection mechanisms of international organizations. The Hungarian CC set up a complex benchmark system for the protection of social rights, in which the principle of acquired/purchased rights and the right to properties are the key elements. The latter – similarly to the German CC – safeguards the entitlements, too.

The alterations in the role of social rights should also be discussed, especially under current economic circumstances. In times of fiscal and economic restrictions, the limitations on the extent and content of social rights should be examined, setbacks explained.

6. Conclusion

As a summary, it can be stated that the practices of Western European states in flexible retirement follow widely different patterns and models and on account of a changing economic environment the practices are also restructuring. Also, it can be argued that a full exclusion of flexible retirement carries long-term risks for both the society and the funding of the pension systems,

The ambitions to create a flexible retirement pension system have risks (e.g. overloading the pension systems, abuses), but also advantages (e.g. rapid response and correction, higher level of social acceptance). At the introduction of such system these pros and cons must be balanced in order to achieve the desired goal. Avoiding economic and demographic comprehensive studies would lead to false results. Current economic trends coerce states to more prudent management of social support that led to the introduction of restrictions on the conditions of flexible retirement plans. Yet, it is desirable to reinstate flexible elements to the system in order to increase the willingness to pay contribution and to raise satisfaction of active employees.

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