ALTERNATIVE METHODS OF ENSURING WELFARE IN OLD AGE

Roman Lang*

Abstract: *Alternative methods of ensuring welfare in old age is one of so called 'frequently asked questions'. Many people are interested in this topic and there are also many different opinions, 'guaranteed' recommendations as well as many myths or misinterpretations within the society. The article presents the summary of mostly mentioned methods (complementary pension savings, creation of savings, building savings, insurance products, immovable property for one's own residence, investment in children) and gives a brief evaluating commentary to each of them (advantages, disadvantages) coming from the author's experience gained during his activity within the Ministry of Labour and Social Affairs.*

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The topic chosen is a clear example of the overlap of "private" and "public" elements. The system in the Czech Republic, as well as in many other countries, is characterised by state concern for the welfare of citizens in their old age so that they can live their lives with as much dignity as possible – the state provides the legal framework for and organizes the complex public pension insurance system, based on the mandatory participation of economically active persons, or on the automatic participation of certain economically inactive persons. At the same time, there are other institutions providing insurance that are based purely on private law – they provide insurance options for individual persons, and whether individuals take advantage of them or not depends fully on their decision and means; these can be considered **alternative methods of ensuring welfare** in the old age as mentioned in the heading of my paper.

These private law-based insurance options correspond with the concept of income solidarity in the state pension system where the so-called pension replacement rate (i.e., the rate between the amount of the pension insurance benefits and the average income earned before retirement) is, in the case of persons with a high income, lower than in the case of persons with a low income (high income persons reach a rate of about 30 percent or less, while low income persons may reach a rate of 80 percent or more). This solidarity is usually justified by the fact that persons with a higher income have more options for alternative social welfare and it is their responsibility to take advantage of them. An analogous situation applies to self-employed persons, who have had many ways to "optimize" their income within the pension system, which in most cases has had them paying the lowest possible contributions to the system, resulting in a low state pension; they should therefore consider whether and how to utilize the real surplus profits, which many of them make, for the purpose of their future welfare.

We often hear experts as well as the general public pronouncing the phrase *"do not rely only on the state in your old age, think about covering your needs from your own sources*",

* JUDr. Roman Lang, Ph.D., Faculty of Law, Department of Labour Law and Social Security Law, Charles University, Prague, Czech Republic

sometimes followed by a warning (almost a threat) that the state will have no funds in the future and everything will be left to the individual and his/her family, as was the case for centuries; these concerns can be described as exaggerated in the current state of affairs, as no available "hard" data indicate such a "tragic" scenario.

I recently watched a talk show on public TV that focused on this issue. The speakers on the show were from institutions that implement the state pension system as well as from those that administer and sell private products. Unfortunately, the problem was presented (mainly due to the group of people invited to speak later in the programme) as a competition between public and private institutes, which is certainly a completely incorrect perspective – the relationship between these two institutes must be complementary.

In the Czech Republic, as well as in other countries, social security provided by the state plays the more important role: although citizens persistently criticise state institutions, which are also under pressure from the media, they are generally considered to be more reliable and certain than private institutions. The long-term **pay-as-you-go system** clearly plays to this desire for certainty; its big advantage over private capital-funded systems is that it minimises the risk of misappropriation, loss, or depreciation of paid contributions, because it does not expose the funds to the risk of fluctuations on financial markets.

We have already mentioned that there is no real reason to worry about a lack of state resources, but we should realise that in times of regularly repeated economic recessions it will be necessary to adopt budgetary measures to bail out the deficit of the pension account (in the Czech Republic we have seen a large deficit recently, but now, in the time of an economic boom, we can see stabilisation). It may be necessary to gradually adjust the basic parameters of the system, i.e., to either further encumber the working segment of the population or to reduce the level of benefits provided by the system.

What is important in this context is not only the amount of the benefit, but also **when the entitlement to it arises**. If we refer to the current table of retirement age provided in the schedule to Act No. 155/1995 Sb., on pension insurance, as amended by Act No. 220/2011 Sb. (in effect from 30 September 2011), many will ask the classic and legitimate question – is it realistic to expect people to work to the age of 67, or even longer? This question can be answered, for example, in the following ways:

- The table is purely theoretical for the majority of the population, it is merely a message for the current young generation, and its authors were certain of changes occurring in the course of time and thus no upper age limit was determined;
- The table does not say that it is necessary to "work" to the age of 67, it only implies that the entitlement to the so-called regular (i.e., not reduced) old age pension arises at that time;
- According to the statistics available, approximately 160,000 old age pensioners work in the Czech Republic, which is a non-negligible number. The question is for which reasons they are working (purely economic or rather social); there is also a large group of people who have reached retirement age and continue to work without drawing an old age pension in order to increase it by several percent – this is the proof that it is possible to work even after the currently set retirement age has been reached, and there is no reason to believe the situation will change dramatically in future;
- The law envisages the alternative of early retirement, and social welfare in the form of a state pension may be obtained as early as five years before the regular retirement

age, but it is necessary to realise that the benefit will be permanently reduced by a rate proportionate to how early the person retired.

It would appear that the arguments mentioned above do not sound very convincing to the majority of the population; the current regulation is often perceived as "intimidation" of the younger generation. Consequently, changes that should appease the situation are underway. The Act No. 203/2017 Coll. effective from 1st January 2018 provides the concept of a cap on the retirement age at 65, and the government has a duty to carry out a review of the demographic development regularly every five years; if the result of such analysis shows a decrease in the sustainability of the current values, the table shall be adjusted. This solution, however, is criticised as being only a populist gesture as it does not bring any change for the current generation of pensioners, and for future pensioners it is a "hope" which may not actually come true in the end.

The so-called **demanding professions**, i.e., professions whose performance has a more negative impact on human health than others and, consequently, can be foreseen to carry a shorter life expectancy for those who engage in it, constitute a specific group called a 'preferred work category'. The concept of so-called preferred work categories (the performance of a statutory number of years in a preferred category represented entitlement to a reduced retirement age), in existence until the end of 1992, cannot now be successfully utilized because almost all employers stopped maintaining special records of these kinds of work activities in 1993. Thus, we can note efforts to find a resolution to provide adequate material welfare for members of these professions before they reach the regular retirement age without further burdening the state pension system. One option currently under discussion is that relevant employees will obligatorily join the so-called third pension pillar, i.e., the system of **complementary pension savings** (hereinafter "CPS") and employers will have a duty to pay the appropriate contributions for that purpose. It will be possible to draw the funds saved in individual accounts held with pension companies in a form already in existence, namely the so-called 'pre-pension' (or old age pension paid out for a specific period of time) – essentially early retirement funded from a private pension scheme with the aim of covering financially the varied time periods before the regular retirement age is reached and the state pension granted.

The 'pre-pension' scheme following long-term participation in a complementary pension savings system is recognised by the current legislation (Act No. 427/2011 Sb., on complementary pension savings, as amended). Participation in this system financed by private funds has not yet been made compulsory, and nor has the amount of compulsory contributions been determined. Every participant receives a prescribed amount of state contribution, and under certain conditions individual contributions by the participant or his/her employer are subject to tax advantages. These are probably the reasons why this type of saving is so popular among the general public, although the amount of state contributions as well as the total amount of funds saved is negligible compared to state pension system. If the participant decides to draw from the 'pre-pension' after the completion of the pension scheme, he/she will receive two main advantages in exchange for providing for his/her welfare from his/her own means, namely free participation in the health insurance system and the assessment of so-called excluded period (in the pension insurance system), i.e., when there is no reduction of the average income received before the date of ‘pre-pension’ (so that the old age pension is calculated from the average income received before the ‘pre-pension’). The funds from the CPS system can also be drawn in the form of a disability pension, one-off compensation, or payment of premiums for a future pension; in the case of early termination, a so-called lump-sum payment can be drawn, which, however, does not benefit from the mentioned advantages (state contributions are not granted and tax deductible items are taxed).

The above-mentioned CPS is an alternative way of ensuring welfare which could be called the **creation of savings**. The creation of savings is often promoted, it can take many forms, for example, the **“classical” deposit of money in a savings account in a bank**. Unlike in the case of the CPS, deposits in saving accounts do not have any advantages, and deposits in bank accounts up to a value of €100,000 are insured against loss according to the relevant legislation (s. 41(a) and the following of Act No. 21/1992 Coll., on banks, as amended). In the CPS system there is no guarantee of non-negative appreciation (it is more an investment than savings, a fact which is frequently not mentioned), the guarantee being kept only in “old” contracts – those which had been made by the end of 2012 according to the previous legislation, namely Act No. 42/1994 Sb., on pension insurance with state contributions.

Similar advantages as those brought by the CPS (or earlier insurance) are available in **building savings**. This is another very popular instrument, where the state ensures a favourable rate of appreciation for an individual’s savings by contributing to the individual’s building savings account. Despite its name, the savings are not tied to building and may be used for other purposes.

Generally, saving is a rather risky method at present, regardless of what form it takes. The problem is that long-term deposits in banks tend to lose their value, i.e., the rate of appreciation does not cover inflation. There have already been cases in Western Europe where banks charge negative interest. The profitability of investment tools depends greatly on the choice of investment strategy and the abilities of the administrator of the entrusted funds. Riskier strategies may bring higher appreciation as well as significant depreciation; less risky strategies will not ensure such a rate of appreciation that would surpass the interest on deposits in bank accounts. Generally, individual persons are recommended to invest only that part of their property that can be spared in future. There is always a risk that the purpose of investment will not be achieved.

In addition to pure savings tools there are private **insurance** products. These include in particular various types of life insurance policies that can take the form of whole life insurance (taking into consideration the surviving persons), or whole life and endowment assurance (which is, of course, more expensive). Experts advise to calculate the sum insured so that it can (in case of survival) adequately complement the state pension. The sum insured in the whole life insurance policy should range from two to five times one’s annual income. There is also insurance for disability (of any degree) or for incapacity to work; these, however, are not pertinent after the retirement age has been reached. It is always necessary to properly peruse the terms and conditions of insurance products.

Surplus money can be invested in immovable property or other commodities. Buying **immovable property for one’s own residence** can be recommended as one of the best methods of welfare in old age, as it enables people to be self-contained in one of life’s basic needs, accommodation. It is an advantage that immovable property usually does not lose value over time, rather the opposite. If the immovable property is not destined for our own accommodation or we do not intend to use it when old, it can be utilised in another way that is beneficial to us or our family (sell it, lease it, give it to our children, etc.) If people need to take out a loan to buy their own home, it is recommended to combine the loan with a whole life insurance or disability insurance policy for the amount equal to the debt, so that in case of inability to earn money or early death the debt can be paid back and the immovable property is free from any encumbrances, repayment of which would be very demanding.

Investment in children is mentioned as yet another alternative. This certainly entails high initial costs; to have children is sometimes considered a luxury that is not for everyone. The state's pro-family policy, however, is relatively well thought out, and helps families cover the cost of having children by providing financial support, the constitutional right to the protection of family is broadly ensured, and concerns about starting a family felt by the majority of the population do not have any real foundation. We can mention, for example, the right to maternity and parental leave; to the holding of one's employment position or to shorter, or another adjustment of, working hours; the right to maternity and parental benefits (both benefits are very reasonable) as well as other social support benefits; the right to count the time spent caring for a child up to the age of 4 towards one's entitlement to and amount of pension; the right to a survivors' pension (widows, widowers, and orphans) in case of death of the subsistence provider, as well as a not negligible range of tax advantages.

Children can assist their parents in care, and also in orientation in the modern world, they can protect them from its perils (senior citizens with children are a less endangered group) and finally, they can help them financially in case of problems. The mentioned measures in support of the population play an important role from the perspective of pension reform, too, as every child born should be seen as a potential future contributor to the system. The current trend of prolongation of the duration of one generation may be reflected in the determination of the retirement age, because as a result of giving birth later, fewer children are born. Then the parents must stay employed longer and retire later since there are not enough members of the young generation capable of paying the contributions needed to fund their pension benefits.