

## **Institutional reforms in ageing societies: legal and political aspects**

### **Background**

Increasing life expectancy, declining fertility and baby boom generations have already led to significant changes in the age structure of the population in EU countries and the trend is expected to continue. These demographic changes are associated with important challenges for societies in general and their public finances in particular. The shrinking of the working age population raises the question of financial sustainability and social adequacy of pension systems, especially those with large pay-as-you-go components. Population ageing also drives up aggregate health expenditures and long-term care of frail elderly will also require more resources in ageing societies.

One way to restore financial sustainability of welfare states would be to reform welfare programs that involve intergenerational redistribution. Eg. the pension system would have to be adjusted to accommodate for the lower demographic support ratio by changing parameters of the pension system (eg: retirement age, replacement rate, contribution rate) or by more fundamental reforms of the system such as a move to (partially) funded schemes or NDC system. Pension systems are however difficult to reform. One explanation is that with population ageing the elderly constitute an increasingly important part of the electorate and programs involving pro-elderly public spending are more likely to obtain majority. Although the validity of this “grey power” hypothesis has been questioned (Kohli and Arza 2011), studies show that there is a general dislike of pension retrenchment and pensioners are widely considered as deserving recipients of government benefits. Even if welfare reforms are adopted, the danger of revoking reforms is present, as the example of the nationalisation of the mandatory pensions pillar in some Eastern European countries illustrate.

There is thus a possibility that welfare state reforms will be hindered or reversed and countries might continue to accumulate public debt, which shifts the burden of financing welfare-state provisions on future generations. This is problematic in an ethical sense since most philosophical views on intergenerational justice regard this as unjust (see eg. Gosseries 2008, Gál et al. 2011). There is an increasing perception that countries should adopt more fundamental solutions to the problem of financial sustainability in ageing societies. It is argued that instead of specific reversible policy measures, countries should apply general legal principles, which could lay the ground for barriers to policies that buy current votes at the cost of future generations.

The research will study what role institutional solutions can play in ensuring long run sustainability of intergenerational redistribution. We depart from the observation that no-policy-change scenario is not viable as macrofinancial constraints are increasing in future due to the apparently unstoppable ageing. Therefore we first aim to study political conditions of welfare reform. The aim is to characterize political causes behind the difficulty of welfare reform, to describe circumstances when democratic political processes are more likely to lead to the reforms needed and explore mechanisms that may provide legitimacy of welfare reforms to ensure the political sustainability of applied solutions. Then in the second part of our research we describe proposed institutional solutions that somehow limit democratic decision making to ensure sustainability of intergenerational redistribution and protect the interests of future generations.

### **Research questions**

#### **1. Political aspects of welfare reforms in ageing societies: the case of pensions**

The pensions system is generally believed to be difficult to reform. Several European countries have nevertheless succeeded to cut back welfare benefits and some have even managed to adopt systemic reforms of the pension system such as the move from PAYG system to NDC or introduction of mandatory funded pillar. Here we study the political aspects of pension reforms in ageing societies. What are the characteristics of political support for pension benefits? What are the political strategies that are needed to reform in a political context basically opposing reforms? What are the political conditions for welfare reforms to endure?

### 1.1. Attitudes towards public spending for the elderly

Here we study determinants of public support for government transfers to the elderly. Theories and evidence regarding attitudes towards redistribution point to "deservingness" as a key concept in voters' minds. These theories emphasise that voters intend to help distressed and deserving individuals. That is, they support transfers, which compensate for poverty due to bad luck, but are reluctant to relieve distress which stems from lack of efforts. Previous evidence shows that pensioners, along the disabled, are perceived as the most deserving group among the major types of potential social transfer beneficiaries (e.g. Oorschot 2000). Second, target groups perceived as incorporating a large share of stigmatized minorities easily become negatively stereotyped as a whole (Gilens 1999).

In a theoretical analysis we describe implications of the differences in public images of the elderly and other target groups. For instance, pensioners are more positively stereotyped than poor families with children but voters may perceive a smaller role of "bad luck" in their current status. Our models predict that the perception of pensioners is less sensitive to additional information on group-characteristics than the one of those active age beneficiaries who receive means-tested transfers. What is more, pension regime characteristics might influence the variance of the fortune parameter in the voters' naive model. Namely, contribution-based regimes leave a smaller role for existing stereotypes in shaping voters' preferences on pensioners' benefits. Under certain conditions, some unexpected policy-implications may follow. Our aim is to compare these implications to those derived from earlier models on the political economy of social security. Our empirical analysis is based on two data sources: an online survey of public perceptions of poverty and cross-national surveys on redistributive attitudes (see section on methodology).

### 1.2. Political condition of pension reform: the role of political ideology and political strategies

The main goal of this research task is to analyse what role the political sphere plays in shaping the pension system and pension reforms. The starting point is that politicians, political parties are playing crucial role in shaping the pension system and direction of pension reforms (Bartha-Tóth 2013). The political decisions are shaped by three major factors: ideological positions of key politicians and political parties (Voegelin 1938, Mises 1949); dominant reform ideas, best practices and recommendations of international bodies (Simonovits 2008); practical considerations and compromises with domestic agents, political actors, key pressure groups (Orenstein 2009). Also earlier reforms also shaping to be path-dependent the next reform (Stark-Bruszt 1998).

In this research project we will we will explore the role of the four political factors listed above during the 1995-1998 pension reform process in Hungary. This major reform introduced the two-pillar pension system following the Chilean example and the recommendations of World Bank and IMF. The main hypothesis of the research project is that as a consequence of various sources of considerable impact, hybridization is taking place. The concept of hybridization was used earlier to analyze the nature of pension reforms in Central and Eastern European Countries (Natali 2004) and to characterize the end result of the reform process, namely that emerged a hybrid system after the reforms combining traditional Bismarckian pension pillar with private saving based pillars (Cerami 2009). The novelty of the research is that it adopts the concept of hybridization on the political process leading to major reform. The research aims to contribute this discussion on the factors that are shaping pension reforms in the political process (for an overview see: Bartha – Tóth 2013) applying the concept of hybridization and making use of qualitative research methods (see section on methodology).

### 1.3. Sustainability of welfare reform in low-trust societies

The assumption of this research task is that in most of the cases the failures of welfare policy reforms do not derive from the lack of policy analytical capacities (Howlett 2009), but rather the political procedural embeddedness built upon particular attitudes and values. In other words, the self-reinforcing mechanism between political trust, legitimacy and procedural fairness (De Cremer-Tyler 2007) may generate either virtuous or vicious circles (Natali 2004). In comparative empirical terms,

the generally lower social and political trust in Southern and Central-Eastern Europe (SCEE) (Newton-Zmerli 2011:181) obviously limits the transferability of “best practice” welfare policy reforms in the SCEE countries.

In our research we intend to explore the major supporting and blocking mechanisms of welfare reform procedures in an EU comparison. Our hypothesis is that in lower-trust SCEE countries mere crisis-constrained welfare reforms will probably be politically unsustainable on longer run. Strong political polarization and fiscal illusion type attitudes of citizens towards welfare entitlements are the most important explanatory factors of the outcome failure of the ‘best practice’ welfare reform policies. Exogenous shocks (e.g. EU- or EMU-accession, global financial crisis and the subsequent Euro area debt crisis) will probably divert the welfare policy procedures from their usual stream, and in lower-trust SCEE countries the risk of non-democratic type deviation is high; either on the short run by delegating the decision-making power to non-elected policy experts or on longer run by undermining democratic values by welfare populism. This research will be based on (see section on methodology).

## 2. Institutional solutions to the problem of sustainability in ageing societies

As the example of pension reform discussed in the previous section illustrates, welfare state reforms might be difficult to implement in ageing societies and even when implemented are often reversed. Consequently, states in ageing countries might be ending up accumulating debt, which effectively redistributes resources of future generations to the present. Protecting the interests of those without a right to vote (children, future generations) might require voters to accept some type of institutional barrier to their freedom of choice. The state can commit itself to take into account interests of future generations by various constitutional solutions (eg. defining their rights in the constitution or setting up institutions that have a mandate of protecting rights of future generations etc.). Other commitment mechanisms include eg. automatic adjustment mechanisms in the pension system, which create a direct link between demographic or economic developments and the parameters of the pension system to assure financial sustainability. Our aim is in-depth study of the proposed institutional solutions, the assessment of their merits and disadvantages and the economic and social context of their application.

### 2.1. How should generations cooperate?: a state-of the art

Here we study the implications ageing for intergenerational equity. The basic question of this literature is the existence and nature of obligations that present generations have towards future generations. Applying the traditional theories of distributive justice to the question of intergenerational cooperation is far from obvious, since the relation between generations is specific in at least three respects. First this relationship is asymmetric: generations born earlier can affect the life of later-born generations but the inverse cannot happen. Secondly, decisions of present generations affect the very existence (the number and identity) of later born generations. A third specificity is that our information about consequences of our decisions in the distant future is limited (Gosseries 2008). In this research task we review normative theories about intergenerational relations. What are the implications of different theories of distributive justice imply for intergenerational relations? What are the implications of these theories in case of population ageing?

## 2. Constitutional solutions to sustainability in ageing societies

Demographic sustainability is a relatively new idea in constitutional law, but the debates it provoked are well-known even beyond the scope of legal scholarship. The following four potential constitutional solutions to ensure demographic sustainability on a constitutional level have been proposed.

(1) Family suffrage, i.e. to give the right to vote to minors, but to make the parents their representatives (proxy-voters) would probably help policies which are more favourable to families with minors (and thus encourage others to have children) (Demeny 1986). Many constitutional lawyers fear, however, that this would be in contradiction to the equality of suffrage. Similar solutions are known in the UK and in France where relatives can vote for you if you are unable to attend the

elections, but this substitution can only happen if you already have the suffrage. But the idea came up mainly in countries with extremely low fertility (Germany, Japan, Hungary) (see Aoki and Vaithianatham 2009, Holste 2005, Reimer 2004, Schreiber 2004, Peschel-Gutzeit 1997, Löw 2002). The only country, which actually had a similar system was Belgium before WWI (Lasserre 1873, 66-68 and Mauranges 1899, 127-132).

(2) Constitutionally guaranteed family subsidies make family planning easier by reducing financial risks, thus the probability of a higher fertility rate could grow. On the other hand, such constitutional rules strongly restrict future democratically elected governments. A connecting problem is how pensions and related demographic changes can be conceptualised in constitutional law. In most legal orders, pensions are generally not protected by the right to property, but rather by general principles of predictability and legal certainty. A protection by the right to property is only applicable as far as the pension is based on the pensioner's own former financial contribution (BVerfGE, 58, 81, 109ff, see Kluth, 2009, 247-289, esp. 256 with further references). Yet another debated constitutional issue is whether family tax subsidies are legitimate (i.e. whether the state is allowed to have preferences as to the family structure) which is normally approved (see Roellecke 1990).

(3) Fiscal councils supervising constitutional debt brakes serve the interest of future generations (Kirchhof 2012, 5) but, again, strongly restrict the traditional democratic budgetary powers of parliaments. A further issue is that the mere debt/GDP ratio is not enough to predict the sustainability of public debt, as several other factors (age structure of population, education system etc) influence this (see Wyplosz 2005). If we, however, include all these other factors, the transparency of the methods will suffer, which also means that the legitimacy of the limitation of the budgetary powers (*Budgethoheit*) of parliaments. This is probably the reason why rather simple numerical debt brakes have been codified in constitutions. In Germany, arts 109 and 115 *Grundgesetz* (yearly deficit brake), in Poland art 216(5) (total debt ratio to GDP), in Switzerland art 126 (expenditure brake) regulate these issues. We can expect more of these provisions in the near future, as the EU Fiscal Compact of 2 March 2012 contains a provision which obliges the signing parties (all EU Member States except for the UK and the Czech Republic) to introduce debt brakes on "preferably constitutional" level (see Levade 2012; Peers 2012).

(4) The conceptualisation of sustainability as 'rights of future generations' can strengthen sustainability, but every new right is by definition a reason to limit another (old) one, i.e. it can lead to the limitation of traditional fundamental rights. It is also unclear who is empowered to represent the future generations (ombudsman, special committees, children, anybody), and how it can be ensured that these organs or people really do represent the rights of future generations. A step, quite radical but debated for a long time, is to confer rights on the nature or at least on animals, which makes the expression of environmental interests easier in the language of rights. The question is, however, the same: how can we ensure to choose the right representative for these rights.

The research will concentrate on existing constitutional solutions (norms and interpretations) all over the world, on the one hand, and proposed solutions, on the other hand. Legal research on these issues is often determined by ideological premises, and the actual (sociological, economic) facts do not seem to disturb most of the authors who venture to analyse demographic sustainability from a constitutional point of view (this applies, unfortunately, both for proponents and adversaries of new constitutional solutions). The idea would be to base proposals on such knowledge and to test these in the circle of social scientists, before naming them as the rights solutions. Special effort has to be made to accommodate the proposals with traditional constitutional principles of democracy and the rule of law. The proposals should be both on the level of norm texts and on the level of interpretations.

### 2.3. Commitment mechanisms in pension systems: automatic stabilisers

Instead of repeated revisions of pension-system parameters many countries introduced automatic links between demographic or economic developments and the pension system as a more durable solution to the problem of financial sustainability. Automatic stabilisers can be attractive for both economic and

political reasons (d'Addio and Whitehouse 2012). The automaticity of adjustments protects the pension system against demographic and economic shocks. Moreover, it provides a logical and neat rationale for changes that would otherwise be politically difficult to introduce. This research will overview automatic stabiliser mechanisms operating in different countries and will discuss the merits and drawbacks of each solution.

## **Research methods**

Our research applies various data collection methods.

In Task 1.1. we intend to carry out data collection on voters' perception of various groups of welfare beneficiaries (the elderly) using a vignette method. We present vignettes which describe various types of transfer recipients - with or without some direct or indirect hints on their behavioural traits. Vignettes will be presented in an online survey on a nationally representative sample of 1000 respondents. Such surveys use a kind of panel which is practically a large pool of potential respondents whose basic socioeconomic characteristics are available prior to the current research. This allows for sampling which ensures representativity. In addition we use the Eurobarometer survey series, which is a programme of cross-national and cross-temporal comparative social research conducted on behalf of the European Commission and is designed to monitor social and political attitudes. This study makes it possible to connect European citizens' poverty attributes on the one hand and opinions on the principles of pension systems (and the underlying value orientations) on the other.

Task 1.2. will use a grounded theory approach, a qualitative research method that is mainly unknown in Hungary (Kucsera 2008). Grounded theory's main strength is its richness and holism with a strong potential for revealing complexity of the social world around us. Although grounded theory research is usually informed by the academic literature the main purpose of it is not to test existing theories but rather to obtain new insights into the studied phenomenon based on rich empirical material and systematic inductive analysis of qualitative data. We do believe that our grounded theory approach may contribute to the discovery of original and heuristic ideas. In contrast to this, testing logically deduced hypotheses often leads to only slightly modified versions of already existing theories (Charmaz 2006: 4-5).

Task 1.3. Our research questions as well as the testing of our hypotheses require the combination of various data sources; indeed, in this case database building is a more complicated first research step than usually. Among others, we plan to use Eurostat data about the welfare expenditures' structural indicators, World Bank World Governance Indicators (WB WGI) and Comparative Study of Electoral Systems (CSES) about governance and political performance, Luxembourg Income Studies (LIS) data to measure the welfare policy impacts and European Social Survey (ESS) data for the indicators of values and attitudes. In addition, we plan a comparative qualitative case study to shed some light on the mechanisms of virtuous and vicious circles in high-trust vs. low-trust socio-political environment.

Other methods used by our research are analysis of legal documents, constitutions and literature review.

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