

SEVERANCE PAY FUND
AS A FLEXICURITY POLICY

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1. The Introduction

Starting point of this paper is the European Commission's Green Paper on "*Modernising labour law to meet the challenges of the 21st century*" in which the Austrian Severance Pay Act (Betriebliches Mitarbeitervorsorgegesetz) of 2002 is shown as an example of flexicurity program and Turkey's long-lasting on-going debate on establishing a severance pay fund. But, before going to explore this subject in detail, let us remember how the flexicurity concept is brought to the agenda of Europe.

The economic and demographic developments of the 1990's and their effects are the basis of a subject that has been discussed for about 15 years in the European labour market and social life. During this time period, economic integrations has increased due to globalization; the SME's started to compete easier with big companies with the implications of advanced technology to our daily life; Europe became older demographically and the birth rates are lower than ever. Alongside these factors, many countries experienced the segmentation of their labour markets that was one of the primary reasons of the creation of European Employment Strategy that is followed by the most important objective put forward in Lisbon Strategy of 2000: making the EU "*the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion*". The Lisbon Strategy constitutes a dilemma, however, for European companies, institutions, governments, labour force and the EU itself. The companies need to work in a flexible labour markets, flexible work organizations and flexible employment conditions to compete and survive in a global economy. The labour force, on the other hand, needs strengthened social security, especially increased social programs for vulnerable groups alongside the flexibility options for increased quality of life. The remedy of this dilemma is one of the most important current socio-political subjects of Europe: Flexicurity.

When we look into the legislations or programs enacted/accepted by countries in order to put the flexicurity concept into the practice we may point out an array of different programs. Dutch Flexibility & Security Act 1999 and the June 2006 Spanish decree easing the conversion of temporary labour contracts into open-ended labour contracts with reduced dismissal costs are two of them that is shown in the Green Paper itself¹. Another paper published by European Commission with the title "*Towards Common Principles of Flexicurity: More and better jobs through flexibility and security*" adds these programs another two: Temporary work in Netherlands and The 'Towards 2016' Social Partner agreement in Ireland. One of these programs, that is also shown as an example of best practice around Europe, in probably every research made on the subject is the severance pay reform of Austria. The reform is the establishment of a severance pay fund instead of a classical severance pay system where the employer is liable to pay a severance to the employee at the end of the employment contract.

Meanwhile, Turkey, as a developing country with the goal to join the European Union and to enable its business world to stay competitive in the globalized economy has been making some reforms. Among this, the enactment of new Labour Act of 2004 constitutes an important cornerstone since the new Act was actually regulating the flexibility needs of the

¹ European Commission, Green Paper on Modernising labour law to meet the challenges of the 21st century, Brussels, 2006, p. 9. available at http://www.europarl.europa.eu/meetdocs/2004_2009/documents/com/com_com%282006%290708_/com_com%282006%290708_en.pdf (11.12.2011)

company instead of rigid rules of old Act (Act no. 1475) which were accepted necessary for protection of labour as the weak side in work relations. The Transitional Article 6 of the Act states that a severance pay fund is about to be established and up until then the old regulation will be in use². “*A severance pay fund shall be established for the severance pay of employees. Employees’ entitlements to severance pay in view of Article 14 of the Labour Act no. 1475 shall be protected until the passage of the new Act relating to severance pay*”.

These developments drove this study to make research on severance pay regulations around the world³. The study found out that there are two main different severance payment systems around the world: “the classical system” and “the funded system”. This classification is actually based on the financing of the system. In the classical system, the responsibility to make the severance payment falls on the employer, whereas, in the funded system, a specially established autonomous fund which bears the responsibility. In their research, Holzman at al., determine four broad types of severance pay funding, on the other hand: (a) Internal and current funding, (b) Internal funding with book reserves within the firm, (c) External provisioning via individual accounts held by a financial market institution, and (d) External provisioning through centralized institutions. As internal funding depends on the employer’s payment, the first two of these broad types belongs to “the classical system”. Nevertheless, the last two, due to their autonomous structure, are part of “the funded system”. The trend is to shift from the classical system toward the funded system. Such regulatory changes occurred in Italy, Australia, Brazil, Peru, (partly) Chile, Columbia, Korea, Venezuela, Morocco, and Tunisia so far⁴.

There are many reason of this shift of which this study discusses in the next chapter. Flexicurity, however, is not one of them. The study argues and points out that the funded severance pay system makes the labour market of the related country more flexicure, therefore, suggests that the main reason behind such change in the regulation should be adopting flexicurity, among other reasons.

2. The Concept of Flexicurity

The researches made on the definition and understanding of flexicurity are numerous. Since this study is not about one of them, it will use the most accepted definition and framework on the literature. In accordance with the most referred definition in academic literature, flexicurity is “*a political strategy that on the one hand, works to increase the flexibility of labour markets, working organizations and work relations simultaneously and in a well-thought manner and on the other, works to increase the securities (employment security and social security) of weak groups both within and outside of the workforce market*”⁵.

² Transitional Article 6 of the Labour Act No. 4857 is as follows: “*A severance pay fund shall be established for the severance pay of employees. Employees’ entitlements to severance pay in view of Article 14 of the Labour Act no. 1475 shall be protected until the passage of the new Act relating to severance pay*”.

³ Limoncuoglu, S.A., “Karşılaştırmalı Hukukta Kıdem Tazminatı Uygulamaları” ASO Medya, Ankara Sanayi Odası Yayın Organı, 44-62 pp., Ocak-Şubat 2010. Available at <http://www.aso.org.tr/b2b/asobilgi/sayilar/dosyaocaksubat2010.pdf>

⁴ Holzman, R.; Pouget, Y.; Vodopivec, M. and Weber, M.; “Severance Pay Programs around the World: History, Rationale, Status, and Reforms” in Reforming Severance Pay an International Perspective (ed. by Holzman, R. and Vodopivec, M.), World Bank, Washington D.C., 2012, p. 75 - 80

⁵ Wilthagen, T. & Tros, F., “The Concept of Flexicurity: A New Approach to Regulating Employment and Labour Markets”, *European Review of Labour and Research*, 10(2), 2004, 166 – 187. P. 5

Although the definition belongs to them, Wilthagen/Tros, also criticised it because of the difficulties involved in defining the concept of flexicurity as just a political strategy. Since the term covers both labour market flexibility and social security, in broader term, the definition and understanding of the flexicurity should be based on these characteristics. Taking this account, the researchers explain the term by following words: *“(1)developing the biographies and labour market careers of employees, which are in a relatively weak condition, by providing work, employment, income and combination security to an extent thus, providing a sustainable, high quality labour market and social inclusion together with (2) numerical (both external and internal), functional, and wage flexibility to an extent in order to keep up with the changing conditions of competition and production timely and adequately.”*⁶

Today, the best analytic framework accepted, in order to analyse flexicurity policies is Wilthagen’s Matrix⁷. It is based on four different types of flexibility and four different types of security developed from the typology of Standing⁸. The matrix is as follows:

Flexibility/Security	Job Security	Employment Security	Income Security	Combination Security
External Numerical Flexibility				
Internal Numerical Flexibility				
Functional Flexibility				
Wage Flexibility ⁹				

External numerical flexibility refers to flexibility for employers to adjust the labour inflow and outflow. Thus, if an employer is free to employ and/or dismiss worker (free from any additional barriers, including increasing cost to hire and fire), to arrange the number of its workforce without any limitation, one might point out the existence of the external numerical flexibility. Internal numerical flexibility, which is also referred as working time flexibility, stand for representing the employer’s ability to adjust the working hours of its workforce. The functional flexibility is about changing the organizational structure of the workplace without any limitation. This includes the ability to transfer the employees to different activities and tasks. Wage flexibility, at last, refers to the ability of employer to adjust the employee’s wage according to the changing conditions in the labour market in broad term. Though, the flexibility looks like a term that only serves to the needs of employer, it actually should be understood as a reciprocative term. For instance, the ability of an employer to fire a worker without showing any good cause and paying additional compensations is, without any doubt, an indicator of external numerical flexibility. The need to end the employment

⁶ Ibid., p. 6

⁷ Ibid., p. 7; Wilthagen, T., F. Tros and H. van Lieshout, “Towards “flexicurity”?: balancing flexibility and security in EU member states”. Invited paper prepared for the 13th World Congress of the International Industrial Relations Association (IIRA), Berlin, September 2003.

⁸ Standing, G.; Global Labour Flexibility. Seeking Distributive Justice. London, Macmillan Press, 1999.

⁹ The term “variable pay” is used instead of “wage flexibility” in some researches.

contract without any adverse effect, however, may arise from the needs of the employee as well. Any limitation that prevents the employee to annul its current employment contract in order to accept a new one with better conditions will also damage external numerical flexibility of the labour market. As a result, evaluating the flexibility types, one should also consider the flexibility needs of the workers.

Job and employment security, on the other end, are actually two contradictory terms and they should be carefully taking into account in the implementation of flexicurity. Job security is the security of the worker to continue his/her current job. Employment security, there against, refers to the security of a person to hold a job, though it might not be the same. What is important in employment security is for a worker to hold a job. The term does not refer to the obligation of an employer to preserve the employment contract of a worker. Instead, it refers to the ability of an employee to find a new job as soon as possible in case of the cancelation of the previous one by any reason. The main objective here is to keep the person in working life. Though, the job security programs are seen the major way to provide such security, the opposite findings of the recent researches made on the actual effects of job security, helped the researchers to redefine the employment security concept. OECD's Employment Outlook for 1999 is a major research in its field¹⁰. With the words of the research, it is clearly stated that *"This analysis strengthens the conclusion that EPL (employment protection legislation) strictness has little or no effect on overall unemployment... Simple, cross-country comparisons suggest that EPL raises employment for prime-age men, but lowers employment for youths and prime-age women, with the overall effect being a net reduction"*¹¹. As the flexicurity's objective is to increase the employment rate while reducing that of the unemployment, employment security is given priority instead of job security. So the major implementation should be the elimination of employment protection legislation. This conclusion, however, does not strictly imply the elimination of job security since there is no evidence that job security implementations are totally affectless. So the optimum balance should preserve between the job security and employment security in order to benefit from the positive aspects of flexicurity. The term "income security" means the protection of the worker's income during transition periods (from one job to another). The workers, however, may need income support during economic downturns while they still keep their jobs. Job stops and slow downs (like short-time pays) are among such situations. Last, the combination security means the security of the worker's job and wage while social responsibilities and obligations (such as personal and family matters) require the worker to take time off. A good examples of combination security might be the paid legal leave right of a worker with the purpose of caring for elderly parents (or family in broad terms).

3. The Classical Severance Pay System

¹⁰ Among the prior researches are: Bentolila, S., and Bertola, G., "Firing Costs and Labor Demand: How Bad is Eurosclerosis?" *Review of Economic Studies*, Vol. 57, No. 3, 1990, p. 381-402; Bertola, G., "Job Security, Employment, and Wages", *European Economic Review*, Vol. 54, No. 4., 1990, p. 851-879; Nickell, S., "Unemployment and Labor Market Rigidities: Europe versus North America", *Journal of Economic Perspectives*, Summer, 1997, p. 55-74.; Nickell, S. and Layard, R., "Labour Market Institutions and Economic Performance", Centre for Economic Performance, Discussion Paper No. 407, September. Forthcoming in Ashenfelter, O. and Card, D. (eds.), *Handbook of Labor Economics*, Vol. 3, North Holland, Amsterdam, 1998; Bertola, G., "Microeconomic Perspectives on Aggregated Labour Markets", mimeo. Forthcoming in Ashenfelter, O. and Card, D. (eds.), *Handbook of Labor Economics*, Vol. 3, North Holland, Amsterdam, 1999.

¹¹ OECD Employment Outlook 1999, Paris, p. 41

Looking the regulations around the World, one might easefully conclude that there exist one common way to organize severance pay, which this study calls the classical system based on the financing. Out of 182 countries that were examined by Holzman at al.¹², in their comprehensive study, the system of 147 countries belongs to the classical system. The severance pay, at its shortest, is the lump-sum compensation made by the employer to the qualified employee at the end of the employment contract. The amount of the payment depends on the years of service and the last wage employee was earning. The payment is made to the “qualified” employee since, almost in all countries, the employee who quits the employment contract voluntarily, for instance, does not have the right of entitlement for such a payment. Voluntary resignation (in contrast to resignation with good cause) is only one out of multiple situations that prevent the employee to earn the severance pay right. The objectives behind the existence of such a severance pay program around the world are numerous and debated highly among academicians. The severance pay is seen mostly as an income support system, but it also constitutes a compensation for job loss, a method of preventing unemployment by raising the lay-off cost for the employer¹³. In countries where the unemployment insurance does not exist, it is also considered as functioning some-how as one, or at least part of it¹⁴. Turkey was an example of such countries up until 1999, when a separate unemployment insurance regulation has been accepted.

The explanation of the classical severance pay system may be broadened but this will exceed the scope of this study which is to analyse the suitability of the systems to the flexicure labour market.

Under this scope, the classical system seems to have limited advantages and serious drawbacks. As the workers receive the payment at the end of the working relations, the money they receive constitutes a part of their income during their joblessness. As the laid-off workers lose their wages/salaries, they are in need of an income support for themselves and their families until they find a new job. One way to provide this income support for the states is unemployment insurance payments. But in fact, severance pay is also another important actor in the income support arena. Accordingly, one may conclude that the classical severance pay system is an income security tool.

Another positive aspect of the classical system is its role on protecting the job of the worker. In the classical severance pay system, unless the regulations force the employer to put aside the employee’s severance rights regularly each month or each year of which the implementation is very rare, the payment is born at the end of the employment contract. As the amount of the payment depends on the years of service and the last wage employee, it is uncertain. That’s why one can describe it as a “hidden cost”. So the rule is: the longer an employee works, the higher the severance payment. Because of these characteristics of the severance pay, the employer becomes unwilling to terminate the employment contract of the worker without any good reasons. This is what is described on the previous paragraphs as job security.

¹² Holzman at al., op. cit., p. 89

¹³ Holzman, R. and Vodopivec,; “Severance Pay under Review: Key Issues, Policy Conclusions, and Research Agenda” in *Reforming Severance Pay an International Perspective* (ed. by Holzman, R. and Vodopivec, M.), World Bank, Washington D.C., 2012, p. 1

¹⁴ Suzek, S.; *Is Hukuku*, Beta Yayinlari, Izmir, 2006, p. 549.

These are actually all one can say about the positive flexicurity aspects of the classical system. Unfortunately, an indebt analysis of the system shows that the system has also several major negative aspects.

First and the most important of all, as the classic system is a major job security implementation, it negatively affects employment security of the labour market. As the employer bears all the financial burden of the severance payments under this system, the payment made should be accounted as personnel cost. Since all the employees do not earn the severance pay right at the end of their employment contract and the amount of the payment is actually uncertain, it is not possible for employers to determine the real cost of their personnel. This uncertainty canalizes the employers to think twice before opening a job position in their organizations. So in fact, the severance pay, besides being a job security tool, is a serious barrier in front of the employment security characteristics of the labour market. Since the flexicurity focuses on employment security rather than job security¹⁵, it is obvious that this is not a good solution.

Second, it is true that the classical system is an income security tool but not to everyone. Major drawback of the system is the coverage problem. Since, only the qualified worker is entitled to severance pay, those who are not qualified or worse who are not seen as qualified by the employer, are not able to receive such an income support during their joblessness period. Usually, the workers need to be laid-off by the employer without any “just cause” or resign from the work with “just cause” to receive the payment. Employees who voluntarily terminate their employment agreement are not entitled to severance payment. The consideration of entitlement depends on the employer. In Turkey, for instance, there are many cases in real life in which, though, the worker should be accepted as “qualified”, the employers reject the status and do not make the payment. It is true that these false considerations are open to trial. The length of the trial, however, works on the disadvantage of the worker. The workers usually already find a job again when they finally receive the severance payment at the end of the trial. This kind of payment, of course, loses its income security characteristics. This negative aspect reduces the coverage of the system. As Gerald Klec points it out in his research on Austria, only one third of the workforce entitles to severance payment¹⁶. So, the income security does not exist for the remaining bigger part. Same is true for most of the other countries¹⁷. So, when the study puts out the classical system as an income security tool, the tool actually is in benefit of limited portion of workers which is far from being a desired outcome.

One more important point should be underlined while discussing the system’s suitability with income security. This is the insolvency of the employers¹⁸. Without doubt, the severance pay is the rights of the workers. So as the years of service grow, the employers’ debts of severance accumulate larger. If in the end, the employer become insolvent and the workers

¹⁵ European Commission, “Towards Common Principles of Flexicurity: More and better jobs through flexibility and security”, Luxembourg, 2007, p. 7

¹⁶ Klec, G., “Flexicurity and the reform of the Austrian severance-pay system”, European Economic and Employment Policy Brief, No. 4, 2007, p. 3.

¹⁷ Hur, J.J., “Korean Severance Pay Reform: For Old-age Income Security or Coverage Expansion?”, paper presented at the International Workshop on *Severance Pay Reform: Toward Unemployment Savings and Retirement Accounts*, Laxenberg/Vienna, November 7-8, 2003.; Jaramillo, M. and Saavedra, J., “Severance Payment Programs in Latin America?”, *Empirica*, Volume 32, Numbers 3-4, 275-307.

¹⁸ Hofer, H.; Reform of Severance Pay Law in Austria, Discussion Paper, Peer Review: Reform of Severance Pay Law in Austria, Wien 2006

Available at <http://pdf.mutual-learning-employment.net/pdf/at06/disspaperpcie%20at%2006.pdf>

lose their jobs, the problem to collect the severance pay arises. In Turkey, for instance, when a big textile company¹⁹ became insolvent in the last decade, more than 500 workers had hardship to reach their labour rights. Probably, many of them did not manage to be paid even if they won the lawsuits in the court. So, the income security aspects of the classical severance pay system includes an important “income insecurity” risk.

Third, as the classical system is about income and job security, the flexibility aspects of the flexicurity does not fit inside. As precised on the previous paragraphs, the classical system forces the employers to think twice before hiring a new worker as well as laying it off. Even if the employers have to lay off workers, they usually need to pay higher compensation because of the severance payment scheme. A similar approach is actually true for the employment decision of the workers, since, they are reluctant to lose their severance payment rights if they decide to quit voluntarily. If for example a worker who has been working for 10 years find a better job, s/he has to give up his/her severance payment in order to change to a better condition. Most of the time, this is not an easy decision to make. Hence, the classical system does not let the market be externally flexible.

Because of its nature, the severance pay system has actually nothing to do with internal, functional and wage flexibility. So it is not possible to make any analysis toward these parts of the flexibility.

4. The Funded Severance Pay System

The funded severance pay system may occur in two different ways as Holzman at al. put forward: Either via individual accounts held by a financial market institution or via common fund held by centralized institutions²⁰. Austria, for instance, is an example of the former while Morocco and Tunisia is the examples of the later. The system basically works as follows:

- Employers make severance payment contribution to the fund (either individual or centralized) on regular basis (monthly – yearly).
- The money put in fund is invested (preferably in state run bonds, etc with low risk)
- At the end of the employment relationship with an employer, the employee applies to the fund management organization for his/her rights to severance pay.
- The management evaluate the reason of the annulment of the contract collecting necessary information from the parties.
- The management decides to make the severance payment, if the worker is “qualified”
- If not, the management does not make the payment but keeps appreciating all the contributions made so far.
- In the future, when an employment contract of the workers is terminated in a way that entitles the workers for a severance payment or at least by the time of retirement, the management makes the payment²¹.

So basically, the main difference between the classical system and the funded system is while the debtor of the severance payment is the employer in the classical system, it is the Fund itself in the funded system. Moreover, while the management of the severance pay is made

¹⁹ Bayraklı Denim Tekstil Turizm İnşaat Sanayi Ve Ticaret Limited Şirketi

²⁰ Holzman at al., op. cit., p. 24-25.

²¹ Some countries allow the worker to withdraw a portion of its money in the fund before entitlement.

solely by the employer in the former, The Fund may be managed by either governmental or private financial institutions either in a pool or in personal accounts in the later. The qualification criteria of the workers are similar in both.

In the flexicurity arena, the funded system provides couples of advantages.

In the first place, as the contributions to the fund are made by employer on regular basis and in advance, the employers bear no hidden personnel costs. Hence, they are not to make additional (severance) payments if they need to lay-off workers. This eliminates one of the barriers in front of the external numerical flexibility since the decision of the employer to hire and/or fire in times of needs is easier to make. The motive behind this idea is simple: If an employer bears no additional financial risk when s/he decides to terminate the employment contract of a worker, s/he will also hire easier. So, the funded system lets employers to adjust their labour inflow and outflow easier.

This finding is obviously from the view point of employers. And this is a good outcome for flexicurity. But, maybe a better outcome, is the funded system's ability to grant the employees the external flexibility as well. As it has been discussed in the previous paragraphs, the classical system, since the qualification criteria requires workers not to quit the employment relationship arbitrary, does actually limits the workers opportunity to transfer to a new, better job. In the funded system, the qualification criteria are similar to the classical system. Therefore, in order for the workers to be entitled to severance payments, the employment relationship should be terminated by the employer without any just cause and/or by the employee with just cause apart from other ways to entitlements. For instance, in Turkey, retirement and compulsory military duty are other events that obligate employers to make severance payments. However, in the classical system, once the criteria are not met, the employer is not obliged to make any severance payment and the worker lose all of his rights. In the funded system, if the criteria are not met, the system will not make the payment to the worker, but previous contribution made on the name of the worker will be kept in the fund for future entitlements.

So if, for instance, an employee who has been working for 10 years find a new and a better job chooses to resign from the old job, s/he will lose his/her severance payment right in the classical system and his severance right with the new employer will start from the beginning of the new employment contract. So the employee will lose all of his rights for the time s/he previously worked. In the funded system, on the other hand, the workers will not be entitled to the severance right but will not lose the contribution made under his/her name totally. The new employer will keep paying the severance pay contribution arising from the new contract, but the fund will combine the new and old contribution together and appreciate the sum. So, when the worker's employment contract ends up with a way that entitles him/her a severance pay, the worker will collect all of the money since the start of its first step to the labour market.

This difference between two systems has a major effect on worker's decision to change to a new, better job. Thus, the funded system also allows external flexibility of the worker.

As, the eligibility criteria is similar between the two systems, it would not be a mistake to conclude that the funded system is also a tool for income (wage) security. In times of unemployment, the workers who has entitled to severance pay may also rely on their payment as income until they find a new job. So actually, from this point of view, there is no

difference between the two systems. The difference arises from the coverage of two systems. Two aspects affect the coverage of the funded system. First of it is the decision making power. Once the employment contract is over and employee applies for the severance payment, the decision of entitlement will be made by the fund management authority instead of the employer who has the first authority in the classical system. This eliminates the risk of intended false decision made by the employers; thus, allowing more worker to get their entitlements. Second, even in times of arbitrary resignation the workers previous contributions are kept in a fund for future entitlements; so, the coverage rates actually never declines. At last, in times of retirement, every working person gets entitled to severance pay. For example, while only one third of the Austrians had the possibility to reach their severance pay in the old severance pay regime, such a risk is eliminated in the funded system. It may occur times that only one third of the working force gets entitled to severance pay, but at the end it is for sure that 100% of all the workers, whose employers paid contributions will reach their severance pay.

While analysing the income security characteristics of the funded system, one should also point out that the funded system eliminates the risk of insolvency of the employer since the contributory payments are made in advance. As long as contributions are collected regularly in advance, which is the responsibility of the fund authority, the workers have nothing to be afraid of insolvency of the employer. Here the risk of the insolvency, where the problem might occur, is on the fund itself if it is not managed and controlled with responsibility. The risk exists. The fund may be let free to makes investments on risky tools. This should be restrained. A better strategy is to let the state bears the responsibility for the insolvency of the fund. This is an important fact especially in times of economic crises.

As put forward on the previous chapter, the severance payment is a major job security tool under the classical system since it raises the firing barriers of a worker. As explained during the explanation of the external flexibility of the funded system, such barriers are eliminated under the funded model. Since the employer does not bear any additional costs of severance pay, it can be concluded that the employers are freer to lay off worker in times of need. As the cost of laying off a worker declines, the employer will find it easier to adjust their workforce especially in unfavourable times. That means less job security for workers. So the funded system is actually decreasing the job security level in a labour market. This, however, is not a bad thing. As the Dutch and Danish examples of flexicurity proved so far, the weaker job security means a greater employment security in the labour market. Employment security increases since the employers are willing to fill a position in a company knowing that the termination of the employment contract will not be a problem once the business and the company needs to. Thus, the shift from the classical system to the funded one also means a shift from the job security to employment security which constitutes a cornerstone of the flexicurity philosophy.

The researchers usually miss one point here. Increased external numerical flexibility and employment security does actually result to the survival of the companies in the long run. This makes a healthier business life with more created jobs. The hidden cost characteristics of the severance pay at the classical system is a major drawback especially in economic downturns. With a greater need of cutting the cost of doing business, the companies survival option might depends on cutting jobs during economic crises. Since this option requests employer to make the necessary severance payments, those companies that are experiencing financial difficulties have nothing but one choice: insolvency. For instance, during the economic crises of 2001, a relatively big textile company in Manisa, Turkey that employs

more than 700 employees needed to be restructured²². That meant the elimination of the majority of the workforce. Since the severance payments (and the payment in lieu of notice) of the workers amounted a serious number and the company was out of cash flows, it could not decrease the workforce which resulted the bankruptcy of the company. The workers could not collect their severance pay, they lost their jobs and the state lost a lot of potential tax revenue. As an entrepreneur lost its capital, its potential to create the future jobs also disappeared. The same story would, probably, have been changed if the severance pay system were funded. As the employer would not be responsible of making the severance payments of the workers, it would be possible for him/her to decrease the payroll and make the necessary savings which would result the survival of the company. The economy would benefit from this option in the future with re-generated jobs, tax revenues and new investments.

5. Conclusion

The researches made on severance pay shows that there exist two main severance pay systems around world depending on the financing of the system: The classical system and the funded system. The responsibility to make the severance payment in the classical system is on the employer whereas such responsibility in the funded system is on the fund authority. While most of the countries in the world prefers to implement the classical system, mostly because of the historical belief that the resulting job security is needed for lower unemployment rate and higher employment rate, recent regulations shows a shift from the classical system to a funded one with the effects of the recent researches that explode the old notion.

The objective of this research is the analyses of the flexicurity characteristics of both systems and their comparison.

The classical severance pay system is a major job security tool as it increases the cost of laying off workers. A side effect of this is the decrease in the employment security of the workers. As it is hard and costly to terminate an employment contract of a worker, the employers are reluctant to hire workers unless they don't have any other options left. Since it is hard to annul the employment contract of a worker the system also constitutes a barrier in front of external numerical flexibility. Moreover, it also prevents the workers change to a new and a better job since such a move would cost them losing their severance pay rights.

The funded severance pay system, on the other hand, performs better as a flexicurity program. As the responsibility of making the severance payment is on the fund authority instead of employers and the employers' contributions to the system are in advance and on regular basis, the severance payments does not constitutes a hidden cost for the employer. This decreases the job security characteristics of the system and increases the employment security of the labour market. When the employers experience less trouble while laying off the workers they tend to hire them easier as well. As the job security decreases, the labour market becomes more externally flexible too. The system also allows the worker to change their job for a new and a better one without the fear of losing their severance right.

Both system looks like having the same income security effect. This is mistaken however since the funded system provide an extended coverage rate as it eliminates the risk of intended false decision made by employer in the classical system and protected investment of

²² May Tekstil Sanayi A.Ş.

the workers even at the times the end of the employment contract does not grant them their severance rights.

The elimination of the insolvency risk of the employer is another major advantage of the funded system.

As a result, the study concludes that the funded severance pay system clearly increases the flexicurity of the labour market and suggests all the countries to change their system with the funded model. Increasing the flexicurity of the labour market should be the real motive behind such a system change.

More research is needed to be done of course for a better use of the funded severance pay system and developing a common standards. As it is possible to organize the funded system via individual accounts held by a financial market institution or via common fund held by centralized institutions, the advantages and disadvantages and the effects of both organization types should be carefully studied. External numerical flexibility's potential effects on keeping the business run in times of economic crises should be given an attention. And last but not least, the definition of types of flexibility and security should be reconsidered as the old explanations are missing some sort of relations. A typical example of that is the understanding of external numerical flexibility from the view point of an employer. As it is explained, the ability of an employee to change to a better job should also be accepted as an external flexibility.