

Simonovits, András

Working Paper

International Economic Crisis and the Hungarian Pension Reform

IEHAS Discussion Papers, No. MT-DP - 2011/11

Provided in Cooperation with:

Institute of Economics, Centre for Economic and Regional Studies, Hungarian Academy of Sciences

Suggested Citation: Simonovits, András (2011) : International Economic Crisis and the Hungarian Pension Reform, IEHAS Discussion Papers, No. MT-DP - 2011/11, ISBN 978-615-5024-42-9, Hungarian Academy of Sciences, Institute of Economics, Budapest

This Version is available at:

<https://hdl.handle.net/10419/108221>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

MŰHELYTANULMÁNYOK

DISCUSSION PAPERS

MT-DP – 2011/11

International Economic Crisis and the Hungarian Pension Reform

ANDRÁS SIMONOVITS

Discussion papers
MT-DP – 2011/11
Institute of Economics, Hungarian Academy of Sciences

KTI/IE Discussion Papers are circulated to promote discussion and provoke comments.
Any references to discussion papers should clearly state that the paper is preliminary.
Materials published in this series may subject to further publication.

International Economic Crisis and the Hungarian Pension Reform

Author:

András Simonovits
research advisor
Institute of Economics - Hungarian Academy of Sciences
E-mail: simonov@econ.core.hu

February 2011

ISBN 978-615-5024-42-9
ISSN 1785 377X

International Economic Crisis and the Hungarian Pension Reform

András Simonovits

Abstract

By 2008, the Hungarian pension system has become too generous and the implied contribution rate hindered growth. When the international economic and financial crisis deprived Hungary from normal credits, its government turned to international organizations for help. The most spectacular element of the conditions attached to the bail-out package was the short and long-run reduction of pension benefits. Within months, the Hungarian government eliminated the unsustainable 13th month benefit, reduced health-insurance contribution rates, replaced wage-price indexation with price indexation and worked out a drastic rise in the normal retirement age in the medium-run. The newly elected conservative party has practically closed the second pillar and plans to use up the released capital to reduce the government deficit, debt and finance public expenditures.

Keywords: international economic crisis, Hungary, pension reform

JEL: F34, F44, H12, H55

Acknowledgement:

This paper was written as a country study to an informal meeting organized by prof. Winfried Schmähl (Bremen) in Karlovy Vary in November 2009. Thanks to Tamás Bauer, Rudolf Borlói, Gábor Oblath, György Németh, Winfried Schmähl, Tsuyoshi Yanagihara and anonymous referees for their help. The usual disclaimer applies. The paper will be published as *Impact of the economic and financial crisis on pension systems in Central and Eastern Europe: Hungary* in a special issue of the journal "Zeitschrift für Sozialreform" ("Journal of Social Policy Research") 1/2011

A nemzetközi gazdasági válság és a magyar nyugdíjreform

Simonovits András

Összefoglaló

2008-ra a magyar nyugdíjrendszer túlságosan bőkezűvé vált, és a szükséges járulékkulcs akadályozta a növekedést. Amikor a nemzetközi pénzügyi és gazdasági válság megfosztotta Magyarországot a normális hitelektől, a kormány a nemzetközi szervezetekhez fordult segítségért. A feltételes mentőcsomag egyik leglátványosabb eleme a nyugdíjak rövid és hosszú távú csökkentése volt. Hónapokon belül a magyar kormány megszüntette a fenntarthatatlan 13. havi nyugdíjat, az ár- és bérindexálást felváltotta az árindexálással, és kidolgozott egy drasztikus középtávú korhatáremelést. Az újonnan választott konzervatív kormányzat gyakorlatilag felszámolta a második nyugdíjpillért és a felszabaduló tőkét a költségvetési hiány és az államadósság csökkentésére, valamint közkiadások fedezésére használja.

Tárgyszavak: nemzetközi gazdasági válság, Magyarország, nyugdíjreform

JEL kódok: F34, F44, H12, H55

INTRODUCTION

Between 1998 and 2010, the Hungarian mandatory pension system had two pillars: the first pillar was a pay-as-you-go public system and the second pillar was a funded private system. While the World Bank (1994) blueprint suggested a modest and flat first pillar, the reformer Hungarian government has opted for a large first pillar which was getting rid of its redistributive features by now and left only a modest room for the second pillar. (For the early evaluations, see Palacios and Rocha (1998), Simonovits (1999), Müller (1999), Augusztinovics et al. (2002), Czúcz, and Pintér (2002).) Contrary to the Hungarian reformers' hopes, this structural pension reform proved to be a hindrance rather than an engine for economic development (Orbán and Palotai (2005), Guardiancich (2008)). The inefficient private pillar has not relieved the public pillar, merely increased the reported budget deficit by the lost revenues due to transition. The public pillar has become the bone of contest of quarreling parties, bloating the pension expenditures.

By the fall 2008, just before the international economic and financial crisis started, the Hungarian government has already stabilized its budget (for a general survey, see IMF, 2010). The accumulated government debt, however, has become very high by the standards of transition countries: 66% of the GDP in 2007 (column 1 in Table 3), though this number should be diminished at least by 10% point, due to accumulated mandatory private pension contributions. In addition, the private firms and persons have accumulated an excessive quantity of low-interest-rate loans and mortgages denominated in foreign currencies, respectively (column 2 in Table 3). As credit has suddenly disappeared all over the world, to obtain new credits or roll over old ones became very difficult if not impossible for Hungary. The government was the first to ask for a huge bail-out loan from the International Monetary Fund, the World Bank and the European Union. The country received the loan within weeks, about 20 billion EURs, but with strings attached: far reaching austerity measures to be taken immediately. Because the country is export-oriented, the worldwide contraction reduced its industrial output about 20% in 2009, causing the GDP to fall by 6.3%. Unlike other transition countries, Hungary was not allowed to follow counter-cyclical budget policy, aggravating the recession and unemployment.

One of the most conspicuous austerity measures concerned the pension system: the Hungarian pension benefits should be reduced immediately and the system be made sustainable in the long run. It is worth citing a sentence from the memorandum: "At the Fall of 2008, the socialist-liberal government accepted that it can only withdraw the fourth part of the loan in the fourth quarter in 2009 if it works out a program on the basis of the

Report of the Pension and Old-Age Roundtable” (Holtzer, ed. 2010, Chapter 1). The Hungarian government eliminated the unsustainable 13th monthly benefit, reduced health-insurance contribution rates by 5% points, replaced wage-price indexation with price indexation and worked out a drastic rise in the normal retirement age from 62 to 65 between 2012 and 2018. In May 2010, the conservative party had a landslide victory and by 2011 closed the second pillar; would use up the released capital to reduce the government deficit and finance public expenditures.

The structure of the paper is as follows: Section 1 outlines the main features of the Hungarian pension system. Section 2 describes the economic crisis and the general reaction to it in Hungary. Section 3 evaluates the impact of the crisis on the Hungarian pension system and old-age protection and Section 4 concludes.

1. PENSION SYSTEM

We have already mentioned the key features of the current Hungarian pension system, but now we turn to the details. Between 1998 and 2010, Hungary had a three-pillar pension system. Pillar 1 is a traditional pay-as-you-go mandatory public system, which is more and more resembles a DC (defined contribution) system. Pillar 2 was a mandatory funded private system, where workers contribute 8% of their gross wage, about 1/4 of their total contribution. The major part of their contribution, 24% of the gross wage in 2008, still went to the public pillar. Persons already working before 1998 could voluntary enter the mixed system or stay in the old one. The latter paid the total of the two contribution rates, i.e. 32%. About half of the persons chose the mixed system between 1998-1999. Since then their share has grown to 70%. Pillar 3 is a small voluntary private system, with overgenerous subsidies.

Among ex-communist countries, Hungary was the first to introduce Pillar 2. The proponents of this reform have been celebrating this step as a deep structural reform, which proved the front runner status of Hungary around 1997. They have been emphasizing the increased liberalization of the economy, the enhanced incentives to report wages and the educational role of the private accounts. In my opinion, these advantages are more illusory than real; moreover, the conservative government (1998–2002) did its best to discredit the mandatory private system. Furthermore, the proponents have not paid sufficient attention to the fact that the contributions diverted from the public system into the private one should be replaced from government money. This diversion has increased the *reported* budget deficit by 1–1.3% of the GDP every year and contributed to

the steady increase in the reported accumulated gross government debt, almost 80% in 2010. (Note the adjective reported, since in my opinion, economically there is no real transition cost! For details, see Beetsma and Oksanen, 2008.) The money what the members of the private pillar contributed to the newly established funds rather to the old public system served the same purposes: a) to pay for the pension of the current pensioners and b) to generate future pension rights. In addition to this unfortunate fiscal operation, the private funds, more correctly mutual saving associations, have not worked as well as could have been expected. To add to the built-in-tensions to such a privatization, the Hungarian government chose the worst moment to mandate the pension funds to increase significantly the share of the stocks in the portfolio in 2008. First, this measure produced a temporary lack of demand for government papers and later it lead to a serious fall in the value of the individual accounts, to be recovered by now. (In comparison to the maximum average loss of 25% in Hungary, the more conservative Slovakian pension funds had hardly suffered any loss.)

The design of the step-child public pillar was also less than perfect. The step-by-step elimination of progressivity has continuously increased higher benefits without triggering a balancing mechanism. The radical raising of the normal retirement age (from 55/60 to 62/62) between 1997 and 2009 has only been effective for females but has hardly changed the effective retirement age of males (60). Moreover, the actuarial reduction for early retirement was lukewarm (0-3 percent per year), it hardly reduced the benefits. For example, the monthly benefits of those males who retired at 60 rather than at 62 with at least 40 years of employment, were not cut at all. The easygoing practice of disability retirement has not changed much, either.

Since 2001, the competing political parties have waged battles over which government had increased the benefits more and which reduced the pension or health-insurance contribution rates more. The most spectacular element of the unsustainable pension increases was the step-by-step introduction of the 13th month pension between 2003 and 2006. Even the annunciation of the Convergence Program in the Summer of 2006 did not contain the necessary reduction of the pension expenditures. (As if a bad joke, at the election of 2006, the opposition promised an eventual 14th month pension by 2010 while reducing the contribution rate by 10% points.) Only minor steps were taken: those working pensioners, who were below the normal retirement age, paid personal income tax after pension benefit again; and for those, who retired after 2007, the employee's contribution was removed from the wage base, reducing newly rewarded benefits by 8%. Small wonder that by 2008, the replacement rate jumped from 57.3 (in 2002) to 69.1%.

Though also increasing the total pension expenditures, the following measures are recommendable: the widow's benefits were increased from 20 to 30% and the pensions of certain year-groups, who retired at "bad years", were corrected.

Like in other (but not all) transition countries, the largest problem of the pension system is not so much the "deteriorating demographic situation" (unfortunately, life expectancy started to grow only quite recently, from 71.5 year in 2000 to 74.0 in 2008) but the low employment rate. According to recent statistics, the employment rate of prime age worker (between 25-54) was 73% and it was only about 35% of oldest active age group (55-64). This meant that too few workers must pay those contributions which cover the benefits of too many pensioners (both "disabled" and early retirees) and unemployed. But the rising contribution rate between 2006 and 2008 also limited the employment.

Another problem has been the spreading of fractured labor careers. Holtzer ed. (2010, Table 1 in Chapter 4) publishes a very important table on this neglected side of transitology. Following Augusztinovics' initiatives, workers are classified in three large groups according to their status as of 2007: a) those with permanent employment (alpha), b) those with intermittent employment (beta) and c) permanent unemployment or nonemployed (gamma). The number of years of employment is 36-30-27 years (column 1), while the relative earnings (in terms of permanently employed workers' average wage) are 91-84-62% (column 2), respectively. The number of points, the product of columns 1 and 2 (column 3) are correspondingly low: 33-26-17, respectively. Note (column 4) that a large part of each category falls below its own average. There is a growing demand to strengthen the means-tested system or simply introduce a flat plus point system (Augusztinovics and Matits, 2010). In a highly theoretical paper (Simonovits, 2009), I argue for the former and against the latter in a country like Hungary, where the tax morale is very low.

2. CRISIS AND REACTION IN HUNGARY

Hungary is a country of 10 million inhabitants, which had a Soviet-type economic and political system between 1947 and 1990. Since 1990 Hungary has become a market economy with alternating democratic governments. Since 2004, it has been a member of the EU. Recently, its per capita GDP is about 60% of the average EU-27.

Between 2001 and 2006, the subsequent Hungarian governments followed irresponsible fiscal policies, producing budget deficits between 4 and 9 % of the GDP, under condition of fast growth (Table 2, last column). One can justly name unbalanced pension policy as one source of these deficits. The real value of public pensions and real

wages had been growing much faster than labor productivity, well approximated by the GDP dynamics especially between 2001–2003 (Tables 2 and 4). The total pension expenditures with respect to the GDP grew spectacularly, from 9.6 in 2000 to 11.6% in 2008) (Table 4) but remained lower than in some other countries, like Italy or Austria. Other factors, like excessive subsidization of housing and heating, overinvestment in motorways, unlimited and often irrational spending on health care and unsustainable reduction of personal income taxes and value added taxes equally contributed to the fiscal imbalance.

An irresponsible political competition for the votes made any moderation difficult if not impossible. Note also that the ratio of public expenditures to the GDP has been very high (about 50%), requiring very high contribution and tax rates, fueling the practice of underreporting incomes and of insufficient labor supply.

With nine more countries, Hungary entered the EU May 1, 2004. For a while the EU has tolerated the irresponsible fiscal policy of the Hungarian government, but finally gave an ultimatum to work out a Convergence Program by September 2006 and execute it within a limited period. Putting aside the unrealistic fiscal plans made for the election held in April 2006, the reelected socialist-liberal Hungarian government finalized a plan which diminished the budget deficit from 9 to 3% between 2006 and 2008.

The government had to mix two pure options: a) to raise taxes and contributions or b) to cut expenditures. With the benefit of hindsight we can say that the government relied too much on raising tax and contribution rates and too little on cutting expenditures. For example, it increased the low-rate VAT from 15 to 20% and introduced a third rate for personal income tax of 40% (in addition to the rates of 18 and 36%). It is small wonder that the GDP hardly grew in 2007. In addition to simple expenditure cuts, there were some successful attempts to whiten the economy, raising the taxation of working pensioners but the expenditure cuts were too timid. Staying with pensions, early retirement was not punished with due force and the unsustainable 13th month public benefit was not withdrawn.

Moreover, in March 2008 three quite modest reforms (introduction of a visit fee at doctors, paying a nominal fee for staying at a hospital and reintroduction of university tuition fees) were defeated at a referendum with an unexpected 80% majority, with an exceptionally high voters' participation (50%). (It is another question that the Hungarian constitution rules out such referendums, but the Constitution Court decided otherwise.) Under such political circumstances, the government immediately withdrew its very ambitious but controversial health care insurance privatization program, the liberals left the government and the socialists had to form a minority government. As an accident, it was just September 2008, when the minority government convinced itself that the era of

restrictions is over and growth can be resumed. And then unexpectedly, the world economic crisis started and hit Hungary especially hard.

There is no need to discuss the causes of the world economic crisis here, but I would like to touch the causes why it was Hungary that was hit second after Iceland and why Hungary was so badly affected. (Since the early days of the crisis, other countries, like Ireland and Latvia have suffered even greater recession, while the Greek crisis defies imagination. By now Hungary has become an average country, but in October 2008, Hungary was alone.)

The basic reason is that Hungary was the most indebted new-member country, with a debt/GDP ratio 66% in 2007. Also, Hungary had a bad reputation for fiscal laxity. (There were other countries with lax budgets but they had lower debts, and still other countries with high debts but they had strict budgets.) A third reason was that relatively high inflation rate (4–8%) was coupled with a stable nominal exchange rate, making it profitable for Hungarian firms and citizens to take up low-interest-rate business and consumer loans denominated in foreign currency, mainly in Swiss franc. Until the crisis arrived, every expert emphasized that these private *loans* are considered as *private* loans and no foreign lender will blame the Hungarian government for the citizens' debts. (Some experts add now that the independent Hungarian National Bank's very strict monetary policy exacerbated rather than mitigated the fiscal tensions.) Note that while the budget deficit dropped from 9 to 4% of the GDP between 2006 and 2008, the current account deficit remained unsustainably high, about 8% of the GDP. And the foreign direct investments represented a strongly dropping share of this category. The rise in the gross external debt to GDP was alarming: from 75 in 2005 to 115% in 2008!

After the crisis started in earnest, the business sentiment made a U-turn and foreign lenders added these private debt obligations to the government debt obligations and started to compare the sum to the national bank's reserves. Realizing that the reserves do not cover the next year's debt obligations, they stopped buying Hungarian government papers, pushing Hungary into a financial crisis.

Under such circumstances, the stability of the nominal exchange rate disappeared, too. From the strong minimum 230 HUF/EUR of the summer of 2008, the exchange rate weakened to 280 by October 21, 2008 and then to 320 by March 2009. (Similar weakening of the exchange rate also occurred in other new member states, namely in Poland and the Czech Republic but unlike Hungary, they had not accumulated excessive mass of private debts in foreign currencies, therefore their credit lines were not menaced.)

The then Hungarian government was still not ready to make all the necessary adjustments. It has already become clear that the tax and contribution rates cannot be raised further but there was not sufficient determination to cut expenditures. It is true that the force of the crisis was not immediately clear. It was characteristic that between September 2008 and January 2009, every month the Hungarian government's GDP growth forecast diminished by 2 percent points, from 3 to -5%. (Note, however, that other countries like Slovakia were much slower to anticipate their future demand shocks.) When the depth of the crisis became clear and the classical solutions lost their credibility, in March 2009 Ferenc Gyurcsány resigned and Gordon Bajnai followed him as a premier.

Within weeks the new premier prepared a new, much more radical austerity program which eventually was well received by the Hungarian and the foreign business circles except for the populist opposition. Although Bajnai had been a senior minister in the previous government, now he promised to be a caretaker prime minister, who would do everything needed, without taking account of the political repercussions in the election next spring. Similarly to other new-member countries, the exchange rate slowly stabilized (270 HUFs = 1 EUR) and the interest rate premium on Hungary's foreign loans also dropped to its half. Outside the pension sphere, perhaps the most spectacular element of his program was the elimination of the 13th month salaries in the public sector of the higher paid employees and freezing the nominal wages there. Heating and housing support were phased out. The pension reform, being a cornerstone of his program, will be discussed in the next Section.

3. IMPACT OF THE CRISIS ON PENSION SYSTEM AND OLD AGE PROTECTION

In Section 1, we have interrupted the story of the Hungarian pension system at the end 2008. Even at the peak of the crisis (March 2009), the old government still dared not eliminate the 13th month benefit. Rather, the government was only ready to eliminate the first half of 13th month benefit for those, who were below the normal retirement age and only maximized it by the national average for the other pensioners, saving only 1/3 of the total amount.

Finally, the Bajnai government took the necessary steps and practically eliminated the 13th month benefits from the second half of 2009. A very ambitious increase of the normal retirement age was put into law: between 2012 and 2018 the normal retirement age will increase six months every year, from 62 to 65, and the minimal pension age will increase

from 60 to 62. Last but not least, the combined wage-price indexation is replaced by a pure price indexation from 2010, cutting the long-run pension dynamics. (Incidentally, this was the only expenditure cut proposed, albeit secretly, by the opposition leader Viktor Orbán in 2008 but in the disguise of “preserving the value of pensions”. Characteristically, it was heavily attacked by the government and caused a temporary drop in the popularity of the opposition.)

To strengthen the incentives to employment, the employer’s contribution rate was reduced from 32 to 27% up to the double of the minimum wage from July 1, 2009 and without limitation from January 1, 2010. There was a danger that the labor demand will not increase as vigorously as expected by the lawmakers and the social insurance balance will be upset. (Both projections have come true.) At the same time, the Bajnai government practically gave up the country’s insistence on progressive income taxation and copying the East-European practice, announced a two-year transition to an almost flat-rate tax. It put into law that the higher marginal personal income tax rate (36 vs. 18%) will start at 200% rather than at 100% of the average gross wage in 2010, and at 400% in 2011, reducing the proportion of progressive tax payers to less than 10 and 1% of the employees, respectively. (To make the reform even more spectacular, and present the tax rates lower, from 2010 the personal income tax was calculated on the base of total wage cost rather than on the gross wage, following the Czech example.) Though there is no firm evidence, the probably weak reaction to this tax reform, almost 1% of the GDP was lost, further limiting the scope of replacing contributions by taxes.

The introduction of price indexation can be a very effective tool in restraining pension dynamics but at the same time, it increases the relative poverty of older pensioners. If real wages increase annually by 2% in the long run, then the ratio of older benefits to current wages will diminish by 2 rather than 1% in each year. It is conceivable that such a measure pushes more and more pensioners into relative poverty, necessitating the strengthening of means-tested pensions. To obtain a precise picture, microsimulation is needed (Horváth, 2010).

To weaken the short-run tension arising in the private mandatory pension system with low yields, the government opened the gates of return from the private to the public pillar to those who are older than 51 year in 2009. Only 2 rather than 4% of the members of private associations used this opportunity, slightly diminishing the reported budget deficit and government debt. To reestablish some sort of guarantee, from 2010 the real value of lifetime contributions was guaranteed. Just before the elections, in early 2010, the old government tried to transform the mutual pension associations into modern pension funds, with guaranteeing capital. Such an institution works more efficiently and is able to provide indexed life annuities to its members. Unfortunately, the President of the

Republic, supported by the conservative opposition, emphasizing the lost rights of the members of the associations, sent the law to the Constitutional Court. The President went as far as proposing a radical modification: temporarily open the possibility of a voluntary return to the monopillar system. The conservatives gained 68% of the seats in the parliament at the elections in April 2010. Between 2002 and 2009 the conservatives opposed every restriction in general and voted against the elimination of the 13th month pension in 2009 in particular. (Note, however, that in a “hidden” TV interview, the leader of the previous opposition admitted that there is no way to reestablish the 13th pensions in the near future!)

At the beginning of June 2010, the new government tried to increase its room of maneuvering. The new prime minister wanted to increase the maximal permitted budgeted deficit from the earlier 3.8 to 7.5%, but—also under the impact of the Greek crisis—the European Commission insisted on the original deficit ceiling and Hungary had to accept the conditions. There were rumors (www.index.hu) about the general opening up the voluntary route from the mandatory private pillar to the public pension system or better still, the closing down of the mandatory private pillar. Such a modification would have reduced the former number from 3.8 to 2.3% and the latter number from 80 to 70%. Probably, these options were also denied in Brussels.

At the same time, the Constitutional Court has basically confirmed the previous government’s original plan for transformation. During summer, it appeared that the ruling conservatives must extricate themselves from the trap they set for their opponents. Events, however, took a different turn.

In August 2010, Hungary joined eight other EU countries and asked the EU to modify its earlier decisions and take into account the transition costs of pension privatization in the budget deficit and the government debt. The fast EU decision was a conditional yes and no. (Note that the three Baltic countries have temporarily suspended the transfer of private contributions to the pension funds, alleviating the budget tensions, while the Polish government radically reduced the private contribution rate in January 2011.)

The Hungarian government acted swiftly: on October 15, the prime minister announced the temporary suspension of the foregoing transfers for 14 months and opening the gates for return to the monopillar system. Without any discussion, the parliament voted for these laws with long-lasting effects. Two weeks later, the prime minister made the next step: practically closed down the bulk of the private pension funds for ever. Though workers are ‘allowed to stay’ in the private system and contribute 10 rather than 8% to their private funds, but in turn they lose *all* rights accruing in the public pillar from 2011! At writing these lines (January 15, 2011) it appears that less than 2% of the membership opted for staying, hoping for a future elimination of this law. Since the

opposition is to apply to the Constitutional Court in the defense of the private pension accounts, the government already curtailed a substantial part of the prerogatives of the Constitutional Court, making any appeal illusory. It is ironic that a large part (1/3) of the money found in the piggy bank will be used to introduce a highly controversial personal income tax system, and the achieved flat rate tax will help the rich and punish the poor. Only the remaining part of the confiscated private pension capital will be used for reducing the government debt. There is a danger that the government will sacrifice the future on the altar of the present. The future of the Hungarian pension system looks dark again.

4. CONCLUSIONS

Between 2001 and 2006 the subsequent Hungarian governments followed an unsustainable fiscal policy. The austerity measures introduced in 2006 contained too much tax increases and too little expenditure reductions, diminishing the growth rate of the economy. While reducing the budget deficits to a feasible level by 2008, the current account remained unsustainably high, due to unrestrained private consumption and private investment financed by foreign loans plus steeply raising interest rates via the premium (CDS). Small wonder that at the arrival of the world economic crisis, Hungary was picked up as the worst risk. Luckily, the two socialist governments (supported by the liberals) were able to obtain huge credits from the international organizations and making the necessary adjustments within a limited time, regained credit. One step in this process was the long overdue reduction of irresponsible pension promises. (Meanwhile other EU countries have suffered worse crises than Hungary!) The question is now whether the present and future governments will be able to preserve the reforms or restart the competition of unsustainable promises. The anti-capitalistic rhetoric of the conservative government in general and the abrupt destruction of the private funds are menacing.

STATISTICAL TABLES

Table 1.

The pension contribution base at age 60

Type of employment	Number of years of employment	Average relative earning	Number of points	Share of below average %
Permanent (alpha)	36.4	90.7	33.0	56.7
Temporary (beta)	30.5	84.1	25.7	64.4
Unemployed or nonemployed (gamma)	26.8	62.0	16.6	87.7
Average	32.8	84.9	27.9	64.7

Source: Table 1 in Holtzer (2010, Chapter 4).

Table 2.

Macroeconomic indicators for Hungary, 2000-2010, %

Year	GDP growth rate	Private consumption, growth rate	Public consumption, growth rate	Current account/GDP	Government balance/GDP
2000	5.2	4.9	1.2	-8.4	-3.0
2001	4.1	5.7	1.0	-6.0	-4.0
2002	4.4	9.9	5.3	-7.0	-8.9
2003	4.3	7.8	5.1	-8.0	-7.2
2004	4.7	2.8	-0.1	-8.6	-6.4
2005	3.9	3.6	-0.1	-7.5	-7.8
2006	4.0	1.9	5.8	-7.6	-9.3
2007	1.2	-1.4	-4.5	-6.4	-5.0
2008	0.6	0.1	-1.9	-8.7	-3.4
2009	-6.3	-8.0	-2.2	+0.6	-4.4
2010*	1.0	-2.5	-2.0	0	-3.9

Table 3.

Government debt and gross external debt 2005–2010

Year	Government debt/GDP, %	Gross external debt/GDP, %
2005	62.0	75.1
2006	65.6	91.1
2007	65.8	98.4
2008	72.9	115.3
2009	77.7	137.3
2010	78.9	132.3

Source: IMF (2010): The latest figures on debt contain a part of the IMF+EU loan, and should be diminished by about 5% of the GDP.

Table 4.

Pension indicators for Hungary, 2000–2010, %

Year	Pension/GDP	Average pension /average wage	Change in the real wage
2000	9.3	59.1	1.5
2001	9.6	59.1	6.4
2002	10.1	57.3	13.6
2003	10.0	56.8	9.2
2004	10.2	60.0	−1.1
2005	10.5	61.1	6.3
2006	10.6	62.3	3.6
2007	10.9	66.9	−4.6
2008	11.6	69.1	0.7
2009	11.0	70.0	−8.0*
2010*	11.0	68.0	0*

Source: IMF (2010)

REFERENCES

- Augusztinovics, M. (coordinator), Gál, R. I., Matits, Á., Máté, L., Simonovits, A., Stahl, J. (2002): “The Hungarian Pension System before and after the 1998 Reform”, *Fultz ed.* 25–93.
- Augusztinovics, M. and Matits, Á. (2010): Point system and flat benefits, Appendix 13 in Holtzer, ed.
- Beetsma, R. and Oksanen, H. (2008), Pensions under Ageing Populations and the EU Stability and Growth Pact, CESifo Economic Studies 54, 4/2008, 563–592.
- Bokros, L. and Dethier J. J. eds. (1998): *Public Finance Reform during the Transition: The Experience of Hungary*, Washington, D.C, World Bank.
- Czúcz, O. and Pintér, M. (2002): “Transformation of Old-Age Security in Hungary”, Schmähl and Horstmann, eds., 277–304.
- Fultz, E. ed. (2002): *Pension Reform in Central and Eastern Europe*, Vol. 1–2, Geneva, ILO.
- Guardiancich, I. (2008): “How not to Implement: Hungarian Pension Reform in an Institutional Perspective, TIGER Working Paper 110, Warsaw.
- Holtzer, P. ed. (2010): Report of the Pension and Old-Age Round Table on its activities between March 2007 and November 2009, Budapest, Hungarian Government.
- Horváth, Gy. (2010): The Microsimulation Model, Appendix 7 in Holtzer ed.
- IMF Country Report on Hungary, No 10/80.
- Müller, K. (1999): *The Political Economy of Pension Reform in Central-Eastern Europe*, Cheltenham, UK, Edward Elgar.
- Orbán, G. and Palotai, D. (2005): “The Sustainability of the Hungarian Pension System: A Reassessment”, Budapest, MNB Occasional Papers 40, Hungarian National Bank.
- Palacios, R. and Rocha, R. (1998): “The Hungarian Pension System in Transition”, *Bokros and Dethier (eds.)* 177–216.
- Simonovits, A. (1999): “The New Hungarian Pension System and its Problems”, Transformation of Social Security: Pensions in Central-Eastern Europe, Müller, Ryll and Wagener, eds. 211–230.
- Simonovits, A. (2009): Underreported Earnings and Age-Specific Income Redistribution in Post-Socialist Economies, Budapest, Working paper of Institute of Economics, HAS MT-DP 2009/27.
- World Bank (1994): Averting the Old-age Crisis, Washington D.C., World Bank.

Discussion Papers published in 2011

Mihályi Péter: Utolérési kísérletek Magyarországon, 1870-2030. MT-DP 2011/1

Zsolt Darvas - Jean Pisani-Ferry: The Threat of 'Currency Wars': A European Perspective. MT-DP 2011/2

Zsolt Darvas: Beyond the Crisis: Prospects for Emerging Europe. MT-DP 2011/3

Barnabás M. Garay - András Simonovits - János Tóth: Local Interaction in Tax Evasion.
MT-DP 2011/4

Maria Csanadi: Varieties of System Transformations and Their Structural Background Based on the IPS Model. MT-DP 2011/5

Mária Lackó: The Poor Health Status of the Hungarians; Comparative Macro-Analysis of the Likely Explanatory Factors on Hungarian and Austrian Data, 1960-2004. MT-DP 2011/6

Fazekas Károly: Közgazdasági kutatások szerepe az oktatási rendszerek fejlesztésében. MT-DP 2011/7

Gábor Kézdi - Gergely Csorba: Estimating the Lock-in Effects of Switching Costs from Firm-Level Data. MT-DP 2011/8

Antal-Pomázi Krisztina: A kis- és középvállalkozások növekedését meghatározó tényezők - A különböző finanszírozási formák hatása a vállalati növekedésre. MT-DP 2011/9

Zsolt Darvas - Jean Pisani-Ferry - André Sapir: A Comprehensive Approach to the Euro-Area Debt Crisis. MT-DP 2011/10