Review of Sociology 27(4): 83–107.

Beyond Nationalization

Assessing the Impact of the 2010-2012 Pension Reform in Hungary[1]

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Manuscript received: 5 July 2017.
Modified manuscript received: 15 November 2017
Acceptance of manuscript for publication: 23 November 2017

Abstract: The Hungarian pension system has experienced strikingly hectic changes over the past decades. Hungary adopted the Argentinean pension model in 1997, which included a compulsory private pension pillar. Thirteen years later, during the economic crisis, the conservative cabinet decided to fully eliminate the mandatory private pillar (the voluntary private pillar remained). This paper is written to assess the impact of the 2010-2012 reforms, with a view not only to examining the nationalization of private pension funds, but also the less discussed elements of the reform package concerning early retirement rules, the disability pension scheme, and social insurance contributions. Our main research question is whether the reforms led to a more sustainable and more equitable pension system. We provide a somewhat paradoxical answer: despite the lack of consultation with stakeholders and the extreme speed of the reform, the overall impact of changes is slightly positive as they have improved the financial sustainability of the Hungarian pension system in the short- and mid-term, while also increasing pension adequacy and replacement rates. The prospects of the pension system in the long run, however, raise serious concerns related to both sustainability and equity. One foreseeable negative process is the increasing inequality among new pensioners, and the growing share of poor among the elderly.

Keywords: pensions, nationalization, sustainability, equity, Hungarian pension system

Introduction

The Hungarian pension system has experienced strikingly hectic changes over the past decades. In the early 1990s, it consisted of a Pay-As-You-Go (PAYG) public pillar[2], an anti-poverty pillar,[3] and a voluntary private pension pillar. In 1997 the Socialist-Liberal

1 This paper utilizes some of the findings of Szikra, Dorottya, Abandoning Compulsory Private Pensions in Hungary Processes and Impacts. Working Paper, International Labour Organization, Geneva, 2015. The authors thank András Simonovits for his valuable observations on earlier versions of this paper and the anonymous reviewers of the Review of Sociology for their helpful comments. We also thank the participants of the conference "Institutional Reforms in Aging Societies" (Pázmány Péter Catholic University, Budapest, Hungary, 8-9 June, 2017), and the participants of Stream 10, "Pension policies – Challenges, reforms, outcomes" at the 2017 Annual ESPAnet Conference (University of Lisbon, 14-16 September 2017) for the fruitful discussions.

2 In the case of pay-as-you-go (PAYG) pension schemes, current contributions finance current pension expenditure.

3 The anti-poverty pillar was not a separate pillar, but consisted of various measures within and outside the pension system. The most important of these were the minimum pension level and the social assistance scheme for poor elderly (időskorúak járadéka).

coalition decided to partially privatize the pension system and a mixed pension system was adopted that resembled the Argentinean model[4] (Müller 1995). The privatization process in the mid-1990s was triggered by internal and external political and economic forces. Problems with the sustainability of the PAYG system due to increases in unemployment and inactivity during the transition years were primary. Sustainability issues coincided in time with the neo-liberal era of institutional reforms, and the activity of supra-national agencies (notably, the World Bank and the International Monetary Fund) in fostering the privatization of pension systems in Latin America and Eastern Europe (Orenstein 1998). The finally adopted mixed system included a compulsory private pension pillar for the newly employed generations and voluntary joiners, the public PAYG pillar, as well as an anti-poverty pillar.

Thirteen years later, the right-wing, conservative government of Fidesz abandoned pension privatization and, within just a few months, decided to fully abolish the private pillar. The radical nationalization of private funds attracted considerable scholarly interest (e.g. Simonovits 2011; Drahokoupil and Domonkos 2012). Less attention was, however, devoted to various other paradigmatic and parametric changes that were also adopted in the rapid 2011-2012 pension reform process. These included contradictory measures concerning early retirement rules, the retirement age, the disability pension scheme, and social insurance contributions.

In this paper we first describe the most important problems related to the compulsory private pension scheme. We then turn to an analysis of the 2010-2012 pension reform process, including its nationalization. We also shed light on more hidden elements of the reform. We briefly touch upon the undemocratic and precipitous way in which the changes were made. We then discuss our main research question and ask whether the reforms led to a more sustainable and more equitable pension system. We provide a somewhat paradoxical answer by arguing that despite the lack of consultation with stakeholders and the extreme speed of the reform, the overall impact of changes is slightly positive as they have improved the financial sustainability of the Hungarian pension system in the short- and mid-term, while also increasing pension adequacy and replacement rates[5]. The prospects of the pension system in the long run, however, raise serious concerns related to both sustainability and equity. One foreseeable negative process is an increase in inequality among new pensioners, and the growing share of poor among the elderly.

Problems with the Mixed System

The 1997 reforms that created a semi-privatized pension system in Hungary were carried out by the Socialist-Liberal coalition with the active support of the World

4 The Argentine parliament approved a pension reform in 1994 which included the adoption of a funded scheme "on top" of the pay-as-you-go system. Pension privatization was reversed in 2008.

5 According to the OECD definition, the "net replacement rate" is calculated as the individual net pension entitlement divided by net pre-retirement earnings, taking into account personal income taxes and social security contributions paid by workers and pensioners.

Bank (see Müller 1995, 1999; Orenstein 1998). In the mixed pension system, newly employed persons were obliged to enter a private pension fund, whereas 'old' employees could choose whether to remain in the solely public PAYG pillar, or shift part of their contributions to a private pension fund. The private pension tier was financed from employees' contributions deducted from the gross wage, and was usually paid directly by employers. From the total 31 per cent of contributions, six to eight per cent (2004; employees' contribution) went to private funds, and 25 per cent (employers' contribution) to the PAYG system. This means that the public pillar remained dominant. Rather than adding one extra tier to the top of the public pension system, the private pension scheme was thus "carved out" of the public tier (Simonovits 2011).

It was envisaged that future pensioners would receive roughly 75 per cent of their annuities from the PAYG pillar and 25 per cent from their individual, private accounts. The compulsory public and private pillars were supplemented with the still-existing voluntary pillar, while the prevention of old age poverty through minimum pensions and the previously means-tested scheme also remained unaltered. The privatized pension system was envisioned to be not only more sustainable than the public PAYG one, but it was hoped that it would also generate additional revenue by increasing employment, boosting economic output and decreasing the hidden economy and channelling savings into more productive segments of the economy (Drahokoupil and Domonkos 2012:288-289).

The mixed system became surprisingly popular, with around 2.4 million members in 2004 and 3 million in 2010 (about three-quarters of the total labour force). Most employees (cc. two million) entered voluntarily. One of the most important problems with the mixed system was that, due to a largely unnoticed rule, those who had some public pension rights lost 25 per cent of the value of these by joining the mixed system.[6] In fact, the majority of employees who entered voluntarily, and especially older generations, lost out with the mixed system. Certainly, people were not sufficiently informed about the drawbacks of the private system, while its merits were overemphasised. According to the model of Orbán and Palotai (2005) (who calculated using a 2.1 per cent average net real yield from private funds, although the figure was, in reality, much lower), future average pensions in the mixed system would have been substantially lower than pensions in the solely public pillar (ibid: 27, Figure 9).[7] According to Simonovits (2009:19), losses acquired in the mixed system after 20 years of service were between 9.8 and 12.5 per cent, and reached more than 18 per cent in case of 30 years of service. Furthermore, rather than individual employees it was typically employers who chose a pension fund, and this lead to mass entrance into some of the largest funds and an overall increase in private

6 It was hoped that this loss would be compensated for by the high returns of the private pillar at the point of retirement. Notwithstanding this, taking away 'earned' social security rights was held to be unconstitutional by Augusztinovics (2000).

7 Even with an (unrealistic) 3.4 per cent yield, older pensioners would have been slightly better off had they remained in the public pillar.

fund membership.[8] In their early assessment of the mixed system, Gábos and Janky (2000) found that besides personal features (like age or labour market situation) employers played a significant role in encouraging employees to enter the mixed system, even when it was "not in the employees' unambiguous interest" (ibid:519).

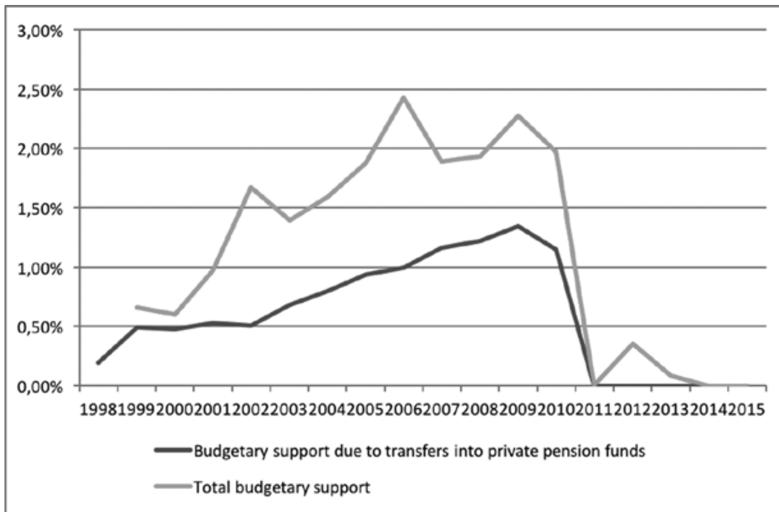
Experts agree that proponents of the privatization of the Hungarian pension system in the mid-1990s failed to address the greatest risk of the reform: the funding-gap problem (e.g. Barr and Diamond 2008; Drahokoupil and Domonkos 2012:288). Transition costs were clearly underestimated as the number of people joining the mixed system turned out to be substantially higher than expected by reformers. Thus, paradoxically, it was the "success" of the private pension system that caused the greatest sustainability problems. The funding gap arose from the decreasing share of contributions paid into the public system (shrinking from 24 to 18 per cent between 1998 and 2002) and the ongoing costs of contributory and non-contributory pension payments realized from the public pillar. As the Hungarian state guaranteed it would maintain the real value of the PAYG pensions, the fiscal burden on the Hungarian state increased from 0.3 per cent in 1998 to 1.2 per cent of GDP by 2010. Transition costs were financed from direct and indirect taxes[9] and also induced additional government borrowing from abroad (Mesa-Lago 2014:10).

But it was not only privatization, but also further parametric reforms (such as, for example, the adoption of the so-called "thirteenth month pension" in 2002) that contributed to the troubles with the financial sustainability of the system (Orbán and Palotai 2005:10). Figure 1 shows that about half of all the costs covered by the state budget in relation to the pension system arose from parametric reforms of the public pillar between 2002 and 2010, while the other half were created by from the transition costs of pension privatization.

8 Private contributions were made directly by employers, and this transfer method "allowed […] employers to influence their employees in their choices of […] funds" (Simonovits 2009:16).

9 VAT in Hungary has been above 20 per cent since the 1990s, and was raised to 27 per cent (highest in the developed world) in 2011.

Figure 1. *Total spending and spending due to the transition to the mixed system provided by the central state to supplement the costs of the public pension pillar in Hungary between 1998 and 2013, % of GDP*



Source: Accounts of the state budget, various years

According to long-term projections, the deficit of the public pension scheme within the mixed system would have remained significantly higher until 2050 than the deficit of a hypothetical single pillar system (in the case that Hungary had not introduced a mixed pension system) (Orbán and Palotai 2005:20, Figure 8). The deficit of the mixed system could not be counterbalanced by the (envisioned) increased net real yields of the pension funds, and related hopes finally faded away with the global financial crisis of 2008.

The third group of problems arose from the management of private pension funds. At the onset of pension privatization, mutual social insurance associations, funds owned by Hungarian banks or companies, as well as multinational banks and insurance companies, entered the market.[10] As a rule, 4-5 per cent of contributions went on operational costs (Simonovits 2009:17), but in reality these costs often amounted to more than 10 per cent. According to Mesa Lago (2014:9), administrative costs accounted to 14.5 per cent of contributions in 2010, or 3.4 per cent of the capital of funds. The charge ratio (calculated as the expected decrease in the future value of pensions due to the fees and levies paid by members) was estimated to reach 25 per cent (Orbán and Palotai 2005:14). Due to such high administrative costs, the average real yield of private pension funds was zero from 1998-2005, with

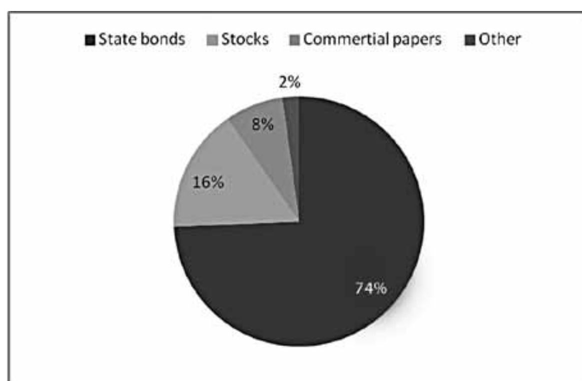
10 The largest multinational companies who entered the private pension business were AEGON, Allianz, Erste, AXA and ING. The largest Hungarian bank, OTP, soon became the leader in the private pension fund market, while ING, AEGON and Allianz (taken together) had the largest overall share of the private pension market (Czajlik and Szalai 2005:29; For later figures, see Hirose 2011:182; Table 5.6).

significant variability between funds (Matits 2008). The real yield of funds fell well below even conservative expectations at the beginning of the privatization process.

A total of 950 billion HUF (appr. three billion EUR at current exchange rates) had been accumulated in the private pension funds by early 2005 (Czajlik and Szalai 2005:36). After a boost of more than 100 per cent in 1998-1999, the assets in funds grew by 40 per cent annually and were equivalent in value to more than 10 per cent of GDP by 2010.[11]

In the circumstances of a falling and later fluctuating Hungarian stock market and a high budget deficit resulting in excessive interest rates, pension funds concentrated their assets in government bonds (Simonovits 2009:20). Approximately three-quarters of the portfolios were held in government bonds in 2004, and the share of stocks remained around 15 per cent (Czajlik and Szalai 2005:37, 52).[12]

Figure 2. *The investment portfolio of private pension funds in Hungary, 2005*



Source: Czajlik and Szalai 2006:37, Table 15.

According to Hirose (2011), government bonds initially constituted 80 per cent of all assets, which decreased to 48 per cent by 2009. Drahokoupil and Domonkos (2012:290) point out that government bonds were often issued to finance the costs of the pension privatization itself, creating a costly "circuitous" way "to return funds to the government".

The 2010-2012 Reforms

The reform of the mixed system was initiated by the conservative Fidesz government that obtained a supermajority in Parliament at the 2010 elections. It must be noted that Fidesz opposed pension privatization from the very beginning and had severely limited

11 This was equivalent to 12.14 per cent of GDP (authors' calculation).

12 Although regulation did not strictly limit this, there was a lack of incentive tofor acquiringe foreign investments, and management of funds concentrated on short-term, low-risk investments.

the role of private pension funds during its first term between 1998 and 2002. In 2010, constrained by an internal and external economic crisis, the second Fidesz cabinet decided to radically reshape the pension system and eliminate the private pension pillar. As argued by Drahokoupil and Domonkos (2012:290), the financial crisis exposed the drawbacks of the private pension system and especially the above-described funding gap problem. This in itself, however, would not have been sufficient for the 're-reform' which was driven by intertwined internal, external economic and political factors.

One important external economic factor was that the strict EU requirements about macro-economic stability provided little room for manoeuvre for member states, especially during the crisis years when they faced economic instability. New member states who partially privatized their pension systems in fact had the opportunity to deduct a gradually decreasing part of transition costs from their budget deficit (to be counted in the excessive deficit procedure) until 2010. The European Commission did not, however, allow for the extension of this derogation in the summer of 2010 which made the conservative government in Hungary rethink its strategy about the pension system.[13] To balance the budget, the first contributions due to private pension funds were directed to the treasury for 14 months (Act CI/2010) and a possibility to return to the public pillar was also created (Act C/2010). Very soon (in late November), a more radical plan to almost completely eliminate the private pillar was introduced to parliament by the Minister of National Economy, and by 13 December 2010 it was adopted without public debate or consultation with the opposition.

Instead of directly confiscating private pension assets, the new legislation proposed extremely unfavourable conditions for those who stayed in the private pillar. It announced that such people would not be eligible for the future accrual of a state pension (75 per cent of one's total pension) although their employers would be obliged to contribute to that scheme. To avoid scrutiny by the constitutional court on grounds of challenges to social insurance rights that had been obtained, contributions paid by employers were redefined as a 'social tax' *[szociális hozzájárulási adó]* to which no future claims could be attached (Act CLVI/2011). The justification for the bill was that 'those who do not return to the public pension scheme will, as it were, "opt out" from the national social security system'. (Bill T/1817:12) Members of private pension funds had only a month to make a decision, and finally 97 percent 'opted' for the pure public scheme. A year later, private fund members regained their rights to make accruals in state pensions but they were not allowed to restart their contributions to the second pillar. By this time, however, only a small fraction of the formal members remained in the private pillar. Contributions by private fund members, as well as all the accumulated assets of former members, were automatically transferred to the newly created 'Fund for Pension Reform and

13 It seems that the EC feared that, without strict macroeconomic constraints, CEE states would become a crisis zone in the way that Greece had.

the Decrease of the Deficit' (Governmental Decree 87/2011), the management of which has been far from transparent.

The separation of disability pensions from the old age pension system in January 2012 (Act CXCI/2011) has been an important though less scrutinized element of the pension reform. The intention of the government was to 'purify' the pension system from disability-related benefits. Disability schemes (together with widows' and orphans' insurance) have been part of the Hungarian pension system since its very beginning in 1928 (Szikra 2009). Through this reform, the re-examination of the health status of people receiving disability pensions also started. Those above normal retirement age (62 years in 2012) became entitled to old-age pensions (app. 400 thousand persons); all others received either disability or rehabilitation benefits (appr. 250 thousand persons), or temporary rehabilitation benefit*]* (appr. 190 thousand persons). The amount of the rehabilitation benefit was around one-third of the net average wage, depending on the health/disability status of the recipient, while the average pension benefit was around two-thirds of the net wage.[14] The benefit is only to be provided for three years, and afterwards is withdrawn, even if one is unable to find a job. People living with disabilities became eligible for a so-called disability annuity, which, in contrast to its name, is a low-level flat-rate form of assistance amounting to less than one-quarter of the average net wage, not linked to earlier labour market performance.

By pushing disability pensioners out of the system and eliminating early retirement opportunities, the overall number of 'pensioners' decreased from 2.8 million in 2011 to 2.2 million in 2012, an 18 per cent drop within just a year (HCSO 2014: 5, Figure 3). In line with the aims of the government to "clear the profile" of the pension fund, the share of old-age pensioners within the total number of beneficiaries increased from 60-63 per cent to 89 per cent in 2012, and to 92 per cent to 2014. Meanwhile, the number of beneficiaries receiving non-insurance-based benefits tripled. Social rights were clearly weakened with the shift from insurance to tax-financed benefits. There is, furthermore, no enforceable right attached to the latter. Overall, approximately 100,000 people were "pushed out" of both systems and were enrolled in the unemployment benefit system (social assistance) and public works programs with much stricter conditions for eligibility.[15]

Early retirement pensions were also drastically reduced (Act CLXVII/2011). The basic rule was formulated that no one who was under the official retirement age after 2012 (set at 62 that year, increasing to 65 by 2022) could receive an old-age pension. Abandoning early retirement and disability retirement schemes was a part of the neo-liberal austerity package of the Structural Reform Programme of 2011. In the case of civil servants, however, it became not an option but an obligation

14 The net average wage was 160,800 HUF in 2016 (HCSO 2017).

15 E.g. in 2013, 25.3 per cent of revised disability pensioners were sent to a rehabilitation program (for a few months) after which they were only deemed be eligible for means-tested social assistance if they accepted public work. http://hvg.hu/itthon/20130321_VG_A_rokkantak_11_szazalekatol_vettek_el (Retrieved: 08-05-2017)

to retire at the age of 62 (or at the official retirement age – in 2016, 63 years of age). Women with 40 years of rights, however, could retire immediately without any deduction according to the new legislation. This measure was justified by providing an opportunity for women to care for their grandchildren, which would, according to the argument, encourage young couples to have more children. This way the conservative cabinet managed to link pro-natalist aims to the pension system.[16] In contrast to pension calculations, time spent in higher education did not count as contributory years, whereas maternity and parental leave did (up to eight years for three children), reflecting the preference of the cabinet for women's caring roles.

The Fidesz cabinet managed to implement its reform agenda in an extremely short time, with the use of procedures considered "unorthodox" in a parliamentary democracy. First of all, the government did not reveal its plans in advance, and did not consult opposition parties, trade unions, private pension funds, civil society or other experts. Second, Fidesz utilized the method of the "individual member's bill" (formerly only used in emergencies) to avoid the rule of compulsory consultation.[17] Third, the government left hardly any time for (legal, social and insurance) experts to follow up, let alone to analyse its activities and react to them.

In 2011, the Hungarian government lead by Fidesz *de facto* nationalized private pension assets and eliminated the second, private pillar. This way Hungary returned to its pre-1998 mandatory pension system, consisting solely of a pay-as-you-go (PAYG) public scheme. The tax-financed poverty elimination scheme remained intact. Private savings in the voluntary pension pillar stayed in place as well, and are currently encouraged by a PIT tax exemption of 20 per cent.

Table 1. *The Hungarian pension system following the 2011 re-reforms*

Pillars	Institution responsible	Financing
1. Old-age poverty elimination (minimum pension and old-age social assistance)	Pension fund + local municipalities	Compulsory contributions + general taxes
2. Mandatory public PAYG	Pension fund	Compulsory contributions (24% employer + 10% employee)
3. Voluntary private pension savings	Private non-profit funds	Voluntary private savings

When the government decided to strongly "encourage" private fund members to switch to the state-run pension system in November 2010, it also promised that their assets would be held on individual accounts within the public pension system. It was also stated that the private pension annuity (directed from the private to the public system) would be inheritable. Following the conversion of the majority

16 This argument fails, however, if we consider that childless women can equally take part in the Women 40 scheme.
17 Later, Fidesz used this method for nearly all important decisions of parliament, including the enactment of the new constitution.

of private fund members and their annuities to the public pillar, Prime Minister Orbán declared that individual accounts would be established in the course of year 2011.[18] These promises have not been fulfilled at all, and individual accounts within the public pension scheme have not been established as of the time of writing (May 2017).

The official retirement age, as described earlier, was raised and was made quite rigid in 2011 with limited or no possibility for early retirement, and in some cases (civil servants) also of later retirement. The retirement age is gradually being further raised (by approximately six months every year) from 62 years in 2015 to 65 years in 2022. The following table shows the gradual increase in the retirement age:

Table 2. *The gradual increase of the retirement age in Hungary, as set in 2011*

Year of birth	Retirement age
1952	62
1953, 1954	63
1955, 1956	64
1957	65

Source: Act LXXXI of 1997, §18.

Pensions are calculated on the basis of average net wages acquired since 1988, valorised to the year before retirement. One needs at least 20 years of contributions to receive a full pension; that is, to be eligible for the guaranteed minimum pension, and above a 50 per cent replacement rate. People with 15 years of contributions can also receive pensions, but at a very low level, with no guaranteed minimum pension. Replacement rates increase in line with the number of contributory years. An eighty per cent replacement rate can be reached with 40 years of contributions. Extra years of service are awarded a yearly two per cent increase; in this way one could obtain 100 per cent of one's former average wage with 50 or more contributory years. In the case that one postpones retirement to later than the official retirement age, a monthly bonus of 0.5 per cent of the originally calculated pension is provided. Most pensioners retire after around 35-40 years of service, and thus receive reasonably high relative benefits (see below). There is no possibility, however, for civil servants to work longer than the statutory retirement age, except for medical doctors, researchers and university teachers.

18 http://www.origo.hu/gazdasag/hirek/20110202-orban-viktor-miniszterelnok-sajtotajekoztatot-tart-szerdan-a-parlamentben.html (Retrieved: 08-05-2017)

Table 3. *Replacement rates according to the number of contributory years in Hungary, 2015*

Contributory years	Replacement rate (% of average monthly wage)
15	43
20	53
25	63
30	68
36	74
40	80
45	90
50 or more	100

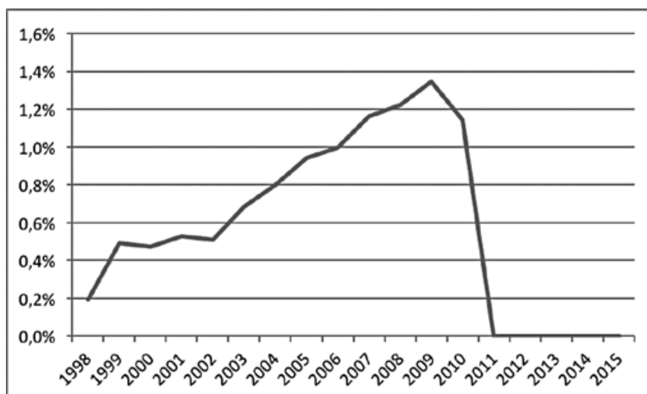
Source: Act LXXXI of 1997, Appendix 2.

The Impact of the 2011 Re-reforms

Macroeconomic and Fiscal Impacts

As analysed above, budgetary support for the pension system sharply increased following the privatization in 1997 due to the transition costs and the decrease in pension contribution rates in parallel with the increase in relative pension levels (from 2002) until 2009. In this year, the thirteenth month pension was eliminated, decreasing state support for the pension system immediately (Figure 1). In 2010/2011 private pension contributions were channelled to the public pension system, which further eased the burden on the budget. The nationalization of private pension assets in 2011, together with the elimination of early retirement schemes and disability pension schemes (the "profile clearing" of the pension system), together contributed to the complete elimination of the fiscal burden on the state budget in the short run. In fact, the public pension fund has had a surplus and contributed to the state budget since 2013.

Figure 3. *The value of central state financing arising from transition to the mixed pension system in Hungary, 1998-2013, % of GDP*



While no official calculations exists about the long-term effects of the re-reform, according to earlier legislation relating to the state budget (Act XXXVIII/1992, §86), the yearly discharge of the implementation of the state budget was required to include long-term calculations about the pension system using the demographic and labour market prognoses of the Hungarian Central Statistical Office (HCSO). Figure 4 shows the 2010, 2011 and 2012 prognoses concerning the sustainability of the Hungarian pension system.[19] It highlights the fact that, according to the Fidesz government, the revenues and expenditures of the pension fund (excluding other resources) will be balanced until 2030, and a sharp decline is envisioned for the years following 2040 due to demographic factors (the effect of low fertility rates and increasing life expectancy) and economic factors (more people with scattered working records start to retire). As the figure also shows, the 2012 post-reform prognosis has been much less optimistic than that of 2011. A similar conclusion is drawn by Freuenberg et. al. (2016:59), who claim that the pension system will be more or less balanced until 2035, while later on it will turn into a deficit, reaching 4-5 per cent of GDP between 2060 and 2040.

Figure 4. *Yearly prognoses (2010, 2011, 2013) of the Hungarian government about the long-term sustainability of the pension system for the period of 1998-2060. (Contributions minus pension expenditures, % of GDP)*

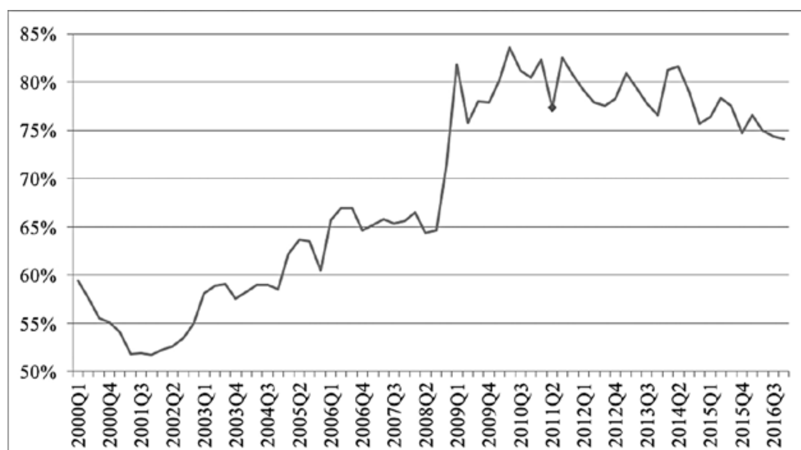
Source: Own calculations based on the appendix of the Law on Central State Budget, various years

The nationalization of private pension assets contributed to a temporary decrease in government debt by five per cent between the first and the second quarters of 2011 (Figure 5). It is estimated that about half of the amount of assets was spent on decreasing the budget deficit, which dropped to a record low 1.9 per cent in 2012, as compared to 4 per cent in the EU27 (HCSO 2013). However, due to various

19 According to the new legislation on the state budget (Act CXCV/2011, §22), no long-term projections musneedt be made any more, but only a three-year short-term prognosis about pension sustainability should be included in the plan for the budget.

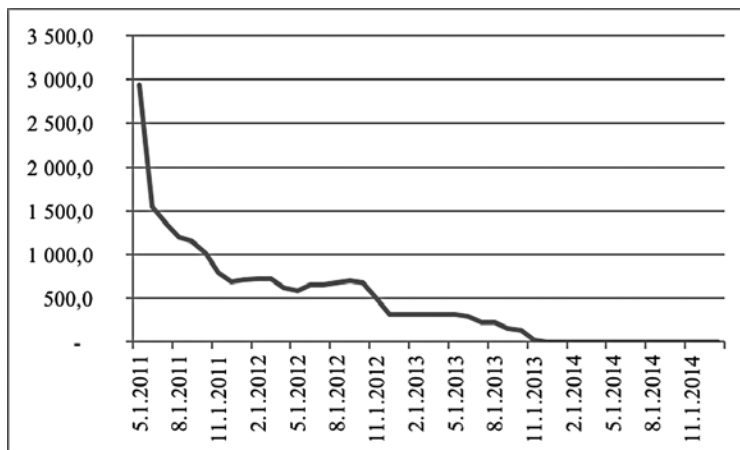
transactions and economic processes (including the devaluation of the Hungarian Forint) the explicit debt of the Hungarian state has not been reduced successfully and reached 82.4 per cent of GDP by 2013, the same proportion as in 2010 (Eurostat 2013). Furthermore, as has been pointed out by e.g. Banyár (2017), the hitherto explicit debt of the state was now transferred into implicit debt.

Figure 5. *Quarterly report on government debt, % of GDP*



The capital of the Pension Reform and Debt Reduction Fund, established by the government to handle the incoming assets of the private pension funds, sharply decreased right after the nationalization of pension funds due to the withdrawal of state bonds transferred from private funds to the state (Figure 6). Half of all the assets that were kept in state bonds were immediately withdrawn once they arrived in the coffers of the Hungarian state. The fund used the majority of its assets to decrease government debt, and, from this amount 243 billion HUF (0.85 per cent of GDP) was used to pay back a loan from the IMF, and a further 81.3 billion HUF (0.27 per cent of GDP) was used to take over the debt of local governments. Furthermore, the fund paid 95.6 billion HUF directly to the treasury (0.34 per cent of GDP) and 363.4 billion HUF to the public Pension Fund (1.28 per cent of GDP) in 2011. Shares in the Hungarian oil company MOL were also purchased so as to acquire a majority from Russian stakeholders.

Figure 6. *Nominal Value of Assets of the Pension Reform and Debt Reduction Fund in Hungary (billion HUF)*



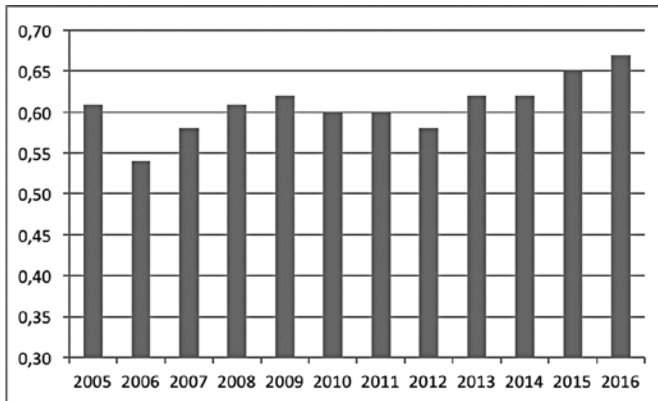
Source: Own calculation based on figures of the Government Debt Management Agency [ÁKK], various years

Coverage, Replacement Rates, Adequacy and Equity

No valuable overall effect of the re-reform can be identified in connection with the general rates of coverage. There has been a substantial shift, however, *within* the pension system due to the elimination of disability pensions. Replacement rates have somewhat increased following the re-reform process (Figure 7).[20] Nonetheless, this cannot be considered an effect of nationalization, but can rather be attributed to other paradigmatic and parametric reforms caused by the 2011 reform package (the elimination of disability pensions, a decrease in progressivity in calculating pensions, cessation of contributions and pension level ceilings and the introduction of beneficial retirement options for women). The elimination of the progressivity of PIT further increases the variability in the level of new pensions (Simonovits 2017).

20 The spectacular wage hikes of 2016 and 2017 might again decrease replacement rates.

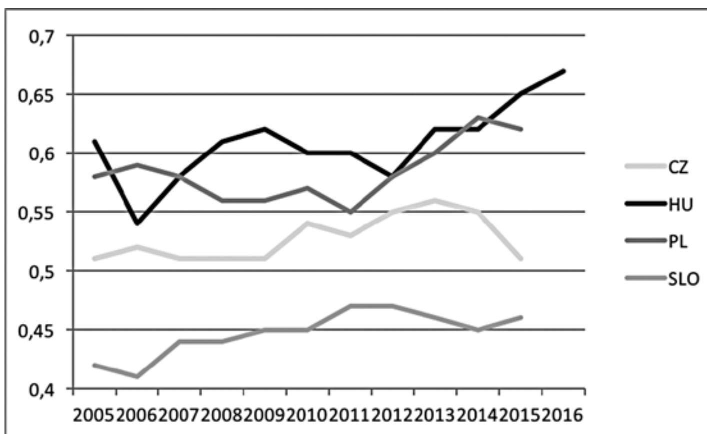
Figure 7. *Aggregate replacement rate of old-age pensions in Hungary, 2005-2016*



Source: Eurostat 2016

The adequacy of the level of pensions has been relatively positive in Hungary if calculated as aggregate replacement rates both compared to other Central and Eastern European countries (Figure 8) and in relation to other EU member states (HCSO 2014).[21]

Figure 8. *Aggregate replacement rate of old-age pensions in Hungary and in CEE countries*

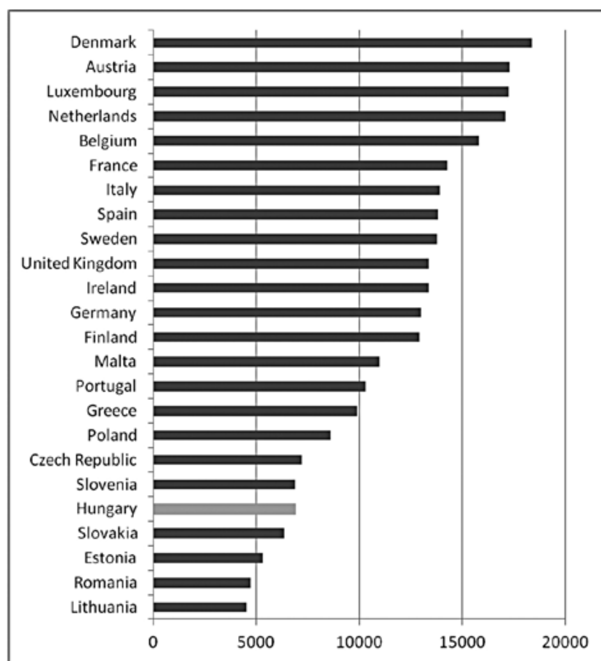


Source: Eurostat 2016

While the aggregate replacement rates show improvement, when calculated in Purchasing Power Parity, Hungary is located within the last quarter of EU member states, indicating the relative disadvantage of Hungarian pensioners compared to their European counterparts.

21 Decision makers recently considered reducing the relatively high replacement rates, buting the no measures have been taken yet.

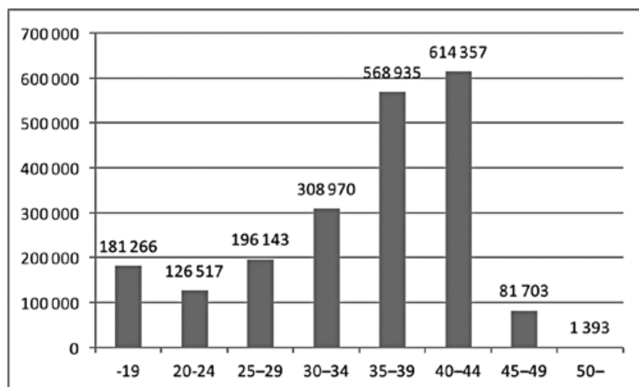
Figure 9. *The annual amount of old age pension per pensioner purchasing power parity in 2013 (PPS/Person)*



Source: HCSO 2014

The largest number of present pensioners (around 1.1 million people) retired with 35-45 years of contributions, and most typically pensions of between 110 and 130 thousand HUF (352 to 416 EUR). The average pension was 115 thousand HUF (368 EUR) in 2014, 75 per cent of the net average wage in 2014 (154,500 HUF or 495 EUR).

Figure 10. *The number of pensioners according to the number of contributory years in Hungary, 2017*



Source: Own calculations based on data of ONYF, 2017

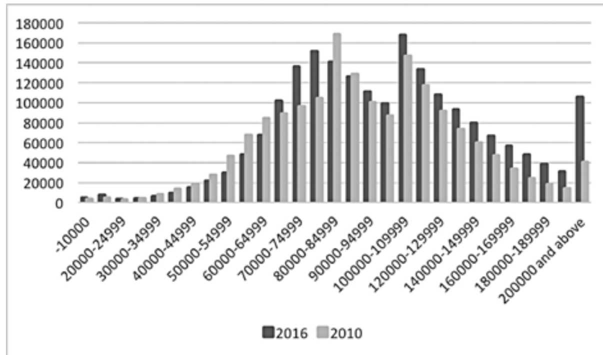
An important though less visible parametric change has been the gradual increase and final elimination of the ceiling on pension contributions and pension levels which furthered the increase in inequality among newly retired old-age pensioners. The ceiling of contributions was introduced in 1992, and in the first years was set at 300 per cent of the gross average wage. In the following decades, the ceiling oscillated between 161 per cent (in 2002) and 311 per cent (in 2009) of the gross average wage.[22] Since 2013, pension levels have been set according to the total wage, whereas for other years they were calculated according to the different ceilings.

Another gradual, no less important change has also contributed to increasing the inequality of pension levels. Progressive calculation, a method of increasing solidarity within the pension system, was a tool which had substantial effects in the early 1990s as it involved lower incomes as well, but it gradually declined in significance since 1998 and as of 2013 was *de facto* eliminated – only 0.5 per cent of pensions were calculated using this process after this date due to the high level of net wages above which progression has to be used (see also Simonovits 2017). This elimination of the progressive calculation of pensions and cessation of progressivity in the PIT system together point in the same direction: towards the massive polarization of pension levels.

Besides the above-mentioned more or less hidden parametric changes, the most important factor that is contributing to the already observable increase in pension inequality is related to the changing pre-retirement labour market position of new pensioners. In the forthcoming years, an increasing share of new pensioners will have fragmented careers because many of them will have made their contributions under the new capitalist democracy, with periodically high levels of unemployment and low employment rates. In other words, a decrease in the share of new pensioners' work record will be associated with the state-socialist period that secured (and obliged) employment. This changing pattern of work records that overwhelmingly affects people who have a lower level of education will be coupled with the eliminated ceiling and lack of progressive calculation, which together will inevitably strongly increase pension inequalities in future years. This change can already be seen in Figure 11, which shows that between 2010 and 2016 the number of pensioners who received a low-level pension increased in parallel with the boost in the number of pensioners obtaining very high pensions of above 200,000 HUF (641 EUR), which translates to 114 per cent of the average net wage in 2016.

22 Lately, the ceiling has remained stable at around 300 per cent. When calculating pensions, each of the yearly ceilings was used (every year a different ceiling was applied to the yearly average wages of employees).

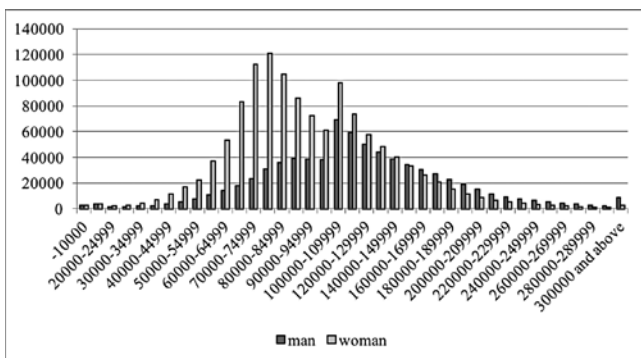
Figure 11. *The number of old-age pensioners according to the amount of benefits in Hungary, 2010 and 2016*



Source: Own calculations based on data of ONYF, 2017

As men are overrepresented among high income earners and women among low earners (due to their lower wages and generally shorter employment records), we also foresee increasing pension-related gender inequality. While the Women 40 programme positively discriminated in favour of women in terms of pension age, this did not lead to an increase in their pensions. The new legislation to ban the employment of civil servants of above official retirement age also affects women to a disproportionate extent as they are overrepresented in the public sphere. Working longer years thus also contributes to the higher pensions of men. In fact, while the overall share of male pensioners was 37.1 per cent in 2016, the share of men among the top 5 per cent of pensioners was 66.2 per cent (ONYF 2017). Figure 13 also shows that most women earned below the median pension, while most men received above the median pension. This gender difference in pension levels is very likely to further increase in the future.

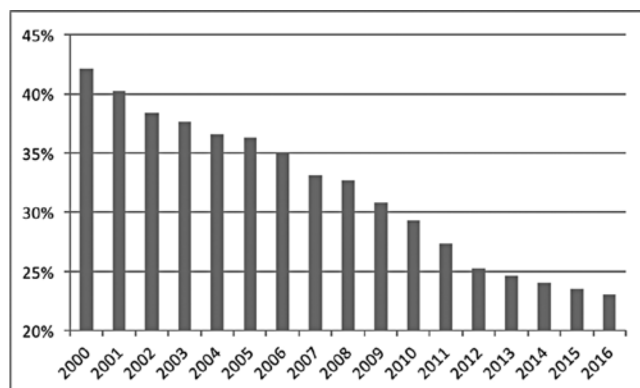
Figure 12. *Number of old-age pensioners according to amount of pension and gender in Hungary, 2016*



Source: Own calculations based on data of ONYF, 2017.

Another factor that contributes to the increasing inequality among pensioners is that the minimum pension level was frozen in 2008 and has not been increased up to the time of writing of this paper (June 2017).[23] The minimum pension is 28,500 HUF (appr. 95 EUR), one-third of the net average wage in 2016. Figure 13 shows that while average pensions have been adjusted for inflation, the minimum pension has not been indexed at all.

Figure 13. *The amount of the minimum pension in terms of the average pension (%), 2000-2016*



Source: Own calculations based on data of ONYF, 2017.

There are, however, only a few hundred people on minimum pensions in Hungary, and the majority receive benefits of a value similar to the average pension (see Figure 12). Around 6,000 people (who do not fulfil the criteria for old age pensions) are eligible for elderly persons' social assistance. This number is likely to rise in the future because of the incoming cohort with fragmented labour market records.

Due to high coverage rates and relatively beneficial replacement rates, the share of elderly people living in poverty has traditionally been low in Hungary. Four per cent of people over 65 years of age were living in relative income poverty in Hungary (below 60 per cent of the median income) right after the pension reform in 2013, as opposed to 14 per cent of middle-aged persons (between 25 and 54 years of age) and 23 per cent of children. While the share of poor children has somewhat decreased recently (19.9 per cent; still among the highest level within the EU), the share of poor elderly slightly increased to 6.8 per cent (HCSO 2015: 21).

Conclusion

The Hungarian government partially privatized the pension system in 1997, obliging young people to enter the mixed pension scheme while making this optional for

23 The reason for this is that all forms of social assistance are calculated as a percentage of the minimum pension in Hungary, including unemployment benefits.

other employees. The designers of the mixed pension system overestimated its possible positive effects, and at the same time downplayed its drawbacks. The greatest problems arose from the increase in the cost of the transition from a fully PAYG public to a mixed pension system, and high operating costs. External pressures, including the global financial crisis, the strict macroeconomic conditions of the EU, and Hungary's borrowing from the EU, WB and IMF, as well as the internal political and economic situation, lead to the decision to re-reform in 2011. The most important driver of the reform was the cabinet's intention to reduce the budget deficit and public debt, while getting rid of the international control of the IMF and the EU with a view to fulfilling its political and economic aims.

The reform process was far from democratic and transparent. Measures were introduced at extreme speed without public consultation. Trade unions, civil society groups, private pension funds and experts were not consulted, and no compromise was sought with opposition parties. The reform was legally designed as if former private fund members could freely choose whether to stay in the private pension pillar or opt for the public PAYG pillar. In fact, the circumstances for staying in were so unfavourable (the loss of a state pension in the future with no compensation if one stayed in the private pillar) that 97 per cent of people "opted" to return to the monopillar public scheme.

Resistance to the re-reform was surprisingly weak, despite the fact that private pension assets were overwhelmingly utilized for non-pension purposes like decreasing government debt. The government also failed to fulfil its promise to create individual accounts. No proper calculations or modelling were revealed by the cabinet and the impact of the changes was not properly evaluated. No transparent information about the use of the assets was communicated to contributors or beneficiaries.

However surprising it may sound, the overall impact of the re-reform is slightly positive, as it improved the financial sustainability of the Hungarian pension system and increased pension adequacy in the short- and mid-term. The improvement in the old-age pension system (that in fact led to a temporary surplus) was achieved through the exclusion of disability pensions from the system, and the complete elimination of early retirement possibilities. In other words, stabilizing the old-age pensions of people with a good labour market position was accomplished at the expense of the most vulnerable workers; that is, people with decreased labour capacities such as those with injuries, disabilities and long-term illnesses. If we account for the decrease in social rights of the above groups, the overall picture becomes gloomier.

Other measures also have led to contradictory outcomes. For example, while the positive discrimination of women in terms of retirement age improved solidarity between women and men, the cessation of the cap on contributions, and implicitly on pension levels, and the elimination of progressive income taxation together with the freezing of the minimum pension level increased the inequality within the

system. There is a danger that the transformation of the employers' contribution into a "social tax" generally weakened enforceable social rights. Hungarian pensioners, however, enjoy rather favourable coverage rates and average pension levels and thus are much less exposed to poverty than younger generations.

Taking the longer perspective, Hungary, after an intermezzo of 13 years, has returned to the old PAYG system created after the Second World War. There is not much chance that the country will depart from this path in the near future, especially now that the currently existing pension system based on a public and a voluntary pillar was incorporated into the 2011 Fundamental Law.[24] However, the prospects of the pension system in the long run raise some concerns, as reserves for future pensions have been used for other purposes in past years, while demographic processes and the meagre employment rates of people with low education levels suggest problems with adequacy that have not been addressed by Hungarian governments of the past quarter of a century.

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24 Art. XIX(4) of the Fundamental Law states that "Hungary shall contribute to ensuring the livelihood for the elderly by maintaining a general state pension system based on social solidarity and by allowing for the operation of voluntarily established social institutions."

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