National Strategy Report
on Adequate and Sustainable Pensions

Hungary

July, 2005.

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*** - preliminary data, 2002, until final validation by Eurostat**

1. Preliminary observations

Interest in Hungary first centred on the sustainability of the pension scheme in the wake of a structural pension reform designed in the 1990s and introduced in 1998, as well as of the gradual raise of the retirement age starting in 1997. The sustainability issue has been spotlighted by extensive NGO circles, too. This background has helped us to design and coordinate the Strategy Report. We began preparations to design the Strategy Report by presenting the targets and methods of open coordination to the advocacy groups included in the effort. The National Seminar organised jointly with EU professionals in July 2003 proved to be an excellent base for this. At the seminar, NGO representatives and well-known researchers debated present-day and future key concerns related to the pension scheme, and certain specific issues connected to the open method of coordination.

An interdepartmental committee made up of the responsible executives of various involved ministries (Ministry of Youth, Family, Social Affairs and Equal Opportunities, Ministry of Finance; Ministry of Employment and Labour) and national bureaus (Hungarian Central Statistical Office; Central Administration of the National Pension Insurance Fund) and recognised independent experts was tasked with designing the system. The specifics for the different areas were elaborated by members of four thematic working groups and independent invited researchers, under the coordination by the Pension Insurance Department of the Ministry of Youth, Family, Social Affairs and Equal Opportunities. A draft report was compiled by specialists from the Ministry of Youth, Family, Social Affairs and Equal Opportunities and the Ministry of Finance, which was then coordinated with the working committees of specialists. After this, it was debated by the Council for Elderly Affairs, a specialist committee within the National Interest Reconciliation Council (as social partners), and numerous NGOs; in addition, the draft report was sent to the relevant specialised committees of the Hungarian Parliament. While agreeing with the contents of the draft report, members of the Council for Elderly Affairs articulated the absence of current issues that are ‘high on the agenda’ of retiree’s organizations, the problem related to exceptional pension increase and they underlined the need to modify the method of indexation. . The social partners agreed that the report was thorough, fair, and well grounded and that its comprehensive approach was a real “breakthrough”. They concurred with the outlook. The cabinet approved the Strategy Report at its July 6 meeting, after it had been debated by the European Coordination Interdepartmental Committee, the Economic Policy Cabinet, and the Conference of administrative state secretaries. The draft report - which reviews the method of open coordination and the joint objectives - was also put up on the Ministry of Youth, Family, Social Affairs and Equal Opportunities’ website for public consultation and comments. The report proved a good occasion for making the components of the pension scheme better known, for promoting retirement awareness and for shaping a longer-term outlook.

2. Main features of the Hungarian pensions system and policy and the major demographic and socio-economic challenges

2.1. Main targets and objectives of the Hungarian pension system

The main institution for providing benefits to the elderly is a statutory pension insurance scheme, which essentially covers all employed and self-employed persons, beneficiaries of unemployment benefits and of certain social welfare benefits. This basic institution for income security provides over two-thirds (nearly three-fourths) of the incomes received by the elderly.

Within the 1997 pension reform, a portion of a system that until then had been a uniform statutory pay-as-you-go pension insurance scheme was partly privatised. Thus, the **statutory pension scheme** has been transformed into a two-component mixed system: the statutory pay-as-you-go **social insurance system** (Act LXXXI of 1997 on the social insurance pension) makes up three-quarters of the system and one quarter is a mandatory **fully funded insurance system** of individual accounts (a private pension fund system, covered in Act LXXXII of 1997 on private pension and private pension funds). Participation in the latter is mandatory for persons just entering the job market, while other insured parties could choose to participate as an option. In addition, a **voluntary fully funded retirement scheme** has been available since 1993 (Act XCVI of 1993 on voluntary mutual insurance funds).

The basic objective of Hungarian pension policy is to offer long-term security of subsistence and guarantee that pensions retain their value. Hungary's declared objectives are

- to provide pensions that are proportionate to the incomes people earned while economically active (the contributions paid) and are consistent with the principle of insurance;
- to see to it that the proportion of GDP devoted to expenditure on benefits within the statutory pension scheme remains sustainable;
- to increase the purchasing power of pensions in proportion with the country's economic performance and the economy's capacity to pay;
- to turn over welfare type pension transfers to the social welfare system so as to prevent distortion of the insurance character of the pension scheme, i.e. the principle of superannuation purchased through, and proportionate with contribution payments;
- to maintain the elements of solidarity based on the principles of social insurance (between genders, and in the invalidity and survivors schemes);
- to continue to promote the individual's prudential concern and the role of the private sector in establishing security in old age;
- to insure the long-term sustainability of the pension scheme.

The shaping of a voluntary mutual insurance fund system in 1993 and the start of private pension funds triggered by the comprehensive pension reform of 1997 required significant changes in outlooks. The message the reform sent to society was that operating benefit schemes for the elderly was no longer solely a government task and that payments by persons in the economically active generations were not the exclusive source of income security for the elderly. Instead, that would depend on insurance and contribution payment attitudes of individuals throughout the courses of their careers. With the voluntary pension funds, savings toward retirement pensions have become a government-supported system, while the private pension funds are essentially a means of accumulating a part of the statutory scheme on individual accounts.

2.2. Review of the major challenges facing the pension scheme

The major risks to maintaining financial viability are as follows:

- **Employment trends.** Trends in employment have and will continue to have a major influence on the pension scheme (Appendix 1, Table 3.2).

  The early 1990s were characterised by the evolving of a labour market, drastic changes in the employment situation (with many jobs terminated, high unemployment rate, sudden and hectic changes) and a drop in the number of people paying taxes and contributions. This contributed to increasing the Pension Insurance Fund deficit. Longer term modelling has made it clear that a rise in employment is essential to being able to manage the demographic challenges. For that reason, raising the employment level is a central issue to domestic labour market policy as is offering incentives to the employment of persons in older ages, too.

- **The demographic challenge.** Considering the expected trends in fertility and mortality and their features specific to Hungary, the growth in the number of elderly and economically inactive persons and the deterioration of the old-age dependency ratio will be a long-term trend according to projections (the baby-boom generations and their children will make up large groups of retirees and the average life span is growing, too. Reducing the scope of the pay-as-you-go scheme, raising the retirement age, and introducing the mandatory fully funded plan and voluntary private insurance funds are all aimed at managing the problem on the long term. The expected increase in the very oldest generations will be a major challenge for the healthcare, social benefits and service systems. Tables 2.0 in Annex 2 illustrate the ageing of the population.

- **Public finance, state budget deficits.** An already significant government contribution is needed to cover the Pension Insurance Fund deficit, which increases the risk of not being able to maintain overall public finance balance. The goal is to gradually increase employment rate and thereby improve the capacity and willingness of assuming general and proportionate sharing in public burdens, and to evolve a system separated by risks and completely self-sustaining in the Pension Insurance Fund.

In other words, the top challenge **is to be able to keep from having to increase mandatory contributions and taxes (in fact, it would be desirable to reduce them!), to keep the pension scheme from hurting overall public finance balance, and to be able to maintain the level of pension benefits.**

3. Meeting the common objectives

3.1. Adequacy of pensions

3.1.1. Policy objectives: social objectives of the pension systems

A goal that has been emphasised since the mid-1980s with regard to re-shaping the Hungarian pension scheme has been to provide a satisfactory income and fair living standard for elderly people (**objective 2)**. It was important to re-design the pension scheme and the social benefits system in order to prevent the elderly population from poverty (**objective 1**), and to display solidarity in conformity with changing social, demographic, employment policy, social, and economic policy conditions (**objective 3**).

3.1.2. The current situation: The tools and achievement of goals

The best way to describe the current Hungarian pension scheme is to say that it is in transition. Starting with the early 1990s, continuous corrections in the statutory pension scheme targeted the reinforcement of the insurance principle. A structural pension reform in 1997 was focused on gradually transforming the social insurance system and establishing a mandatory fully funded scheme. As one portion of the measures introduced to the system (raising the retirement age, rules for calculating pensions) require a 10-15-year transition before their effects become tangible, while others will take effect after 2013, current figures on the adequacy of pensions tend to really reflect the effects of the former social insurance pay-as-you-go system. The role of the fully funded system established by the reform will become significant starting with the 2030s, therefore it does not really play a role in assessing the current situation; however, it does have a vital function in ensuring the sustainability of the system and the future adequacy of pensions. This transitory nature accounts for the different importance assigned to the individual sub-systems in assessing the Hungarian pension scheme on the basis of 11 goals.

In the 1990s, the following measures and corrections were made to ensure adequacy of pensions:

- the former system underwent continuous correction, including tightening up of entitlement criteria, as well as removing the social welfare profile and typical government transfers and assistance payments from the system (with the enactment of Act III of 1993 on Social Administration and Social Benefits);
- the prior system, which took the years with highest earnings into account in calculating pensions, was replaced by a system that paid more attention to lifetime earnings (instead of the best three of the last five years before retirement as a basis for pensions, the system now called for including earnings for every single years following 1987);
- increasing retirement age[1]: shifting from the former system with a retirement age of 55 for women and 60 for men to a uniform 62 years for both genders, effective in 2009;

[1] During the transition period, the law does not set any specific age limit directly, but defines entitlement to pensions by year of birth. For men, the 62-year retirement age has been in effect since 2000.

- conditions for receiving the guaranteed minimum pension have been tightened up significantly (requiring 20 years of contribution payment instead of the previous 10 years);
- introducing a system of indexing the guaranteed pension in 1993, and shifting it to the Swiss indexation system as of 2001. In the meantime, the surviving spouse's pension was significantly increased and a thirteenth month pension is being introduced (gradually, beginning in 2003).

The 1990s were the years in which people were made increasingly aware of the need of assuming a prudential concern and foresight with regard to their own future. When voluntary retirement funds and mandatory pension funds were established and the statutory system was adjusted to market economy conditions, the message conveyed was that income security in old age could be grounded in a longer period of contribution payment with both the government and the individual having roles to play and responsibilities to take.

The voluntary pension funds that have been operating since 1993 have become important elements of old age security. In recent years there has been a significant increase in the number of participants, spurred on by significant tax relief for participants. At present, participants may write off 30 percent (initially they were given a 50 percent relief) on payments into the system up to a certain limit (HUF 100,000/year), an amount that has been increased to 130,000/year for persons retiring in 2020 and beyond. The employers' supplement to the membership fee paid by employees is exempt from pay-roll taxes up to the amount of the monthly minimum wage. The government offers a 20 percent tax relief on commercial life insurance.

Preventing social exclusion, avoiding poverty in old age (objective 1)

Guarantees of minimum pension

A minimum pension guaranteed in the Hungarian pension scheme is not an automatic guarantee of avoiding poverty in old age. The pension scheme itself doesn't ensure this, but operates together with other, supplementary provisions of the social safety net that are means tested.

At least 20 years of contribution payments are required for a guaranteed minimum pension. A person is entitled to a partial pension, for which there is no set minimum, for at least 15 years of service. It is also required that contributions are paid, with few exceptions (child care allowance (GYES) or child care benefit (GYET), outsourced work done at home, part-time employment) in amounts that are equivalent to what would be paid on a minimum wage.

Income guarantee of a different level is provided by the widow's pension which is 50 percent of the pension of the deceased for a surviving spouse who is of retirement age or invalid, provided that the surviving spouse is not a recipient of a pension benefit in his/her own right. A surviving spouse who receives pension of his/her own right (or a widow/er raising two children who are entitled to orphan's benefits) receives 30 percent of the deceased person's pension as a surviving spouse's pension. There is no minimum guaranteed amount for surviving spouse's pension, but when calculating it, the minimum of the pension in one's own right must be considered.

Within the framework of the pension scheme, there is an arrangement called exceptional pension increase for reasons of equity, which allows singular increases in pensions that are less than double the minimum pension. These increases are in response to requests and priority goes to retirees with long service time (since 2002, some 400,000 people received exceptional increases of 6-10 percent).

As of January 2005, pensions paid to some 62 percent of pensioners were below the average pension. Within that, pensions that were just barely above the minimum pension accounted for 10-13 percent.

As of January 1, 2005, the minimum pension was HUF 24,700, with its value declining in the past decade compared to both the average pension level and to the minimum wage. However, only 2 percent of persons receiving pensions in their own right get somewhere around the minimum pension (from under minimum to up to 10-15 percent over minimum). In 2004, the minimum pension amounted to about 40 percent of the average old-age pension. At the same time, it acted as a benchmark in the past few decades in determining entitlement to means-tested social assistance. The assistance level has been adjusted to the minimum pension, which has triggered many anomalies. The declared intention of the 1997 pension reform was to put an end to a pre-set minimum pension and to shift the minimum pension function to a social minimum as the benchmark for determining eligibility for social benefits.

At this time, there is no rule guaranteeing a minimum pension in the mandatory fully funded scheme, but retirees with a short accumulation period are being allowed to opt out and return to the social insurance system until 2013.

Background data is available in Appendix 2., Tables 2.1 to 2.4.

Current guarantees of minimum income

The objective of preventing poverty in old age is not exclusively the function of the pension system in Hungary, but should be considered within the frames of the social protection system as the joint effect of several other tools.

If a person has not acquired a pension in his or her own right, or if the amount of that pension is below a certain level, then, based on need, the person could be entitled to an old age allowance. Introduced together with the pension reform, this social transfer is financed by the government (central and local) budgets; for a person to be entitled to this assistance, he/she must have reached retirement age and must have per capita income, calculated together with that of his/her spouse, below 80 percent of the current minimum pension, or if the person lives alone, below 95 percent. The old age allowance increases existing low incomes to that level. As of January 1, 2006, the amount of old age allowance will be 130 percent of the minimum pension for persons over the age of 75 years who live alone and whose monthly income does not exceed 130 percent of the minimum old-age pension.

At this time very few people are entitled to the old age allowance (in 2003 it was 6,000-7,000 people in all), which means that - as a result of earlier mild entitlement conditions - at present almost 100 percent of the elderly population are covered by a pension or pension-type income.

The minimum subsistence guarantees for the elderly population are built as follows:

- minimum pension attainable with payment of social insurance contributions to 2009, and/or
- supplementary old age allowance which is means tested (category of assistance to provide subsistence), and
- supplementary means-tested additional cash benefits (linked to specific needs - home maintenance support, help with housing debts, temporary allowance, funeral aid), and
- benefits in kind and low or no-cost services (healthcare, free-of-charge medications for the medically indigent, cut rate or free travel, low-cost social services, social catering, home care, senior citizens' clubs, placement in social welfare homes).

The common feature of all supplementary social services is that most are offered by local governments and are jointly financed by the local and central budgets on a normative capitation basis. Healthcare and cut-rate travel are social transfers financed by the central budget.

Elderly persons require intensive healthcare and social welfare services. Healthcare is free of charge for retirees while the co-payment on medications is covered by the indigent medical care scheme for persons whose subsistence would be put at risk by the costs of medications they require regularly. It is estimated that about 330,000 elderly persons or 15.6 percent of the population aged 60 years and over receive this form of assistance.

The most frequently accessed forms of social services, organised on primary care level, are **social catering, home help services, family assistance** and **senior citizens' clubs**, which provide daycare for elderly persons. Specialist care is offered in **live-in homes** that offer temporary or permanent accommodations. The basic condition for accessing these services is social need, which the Social Benefits law interprets in a much broader sense than it does for cash benefits. A person can be declared eligible for these services with a comparatively good income if some other circumstances endanger their usual way of living (e.g.: person is unable to perform activities of daily living or to handle own affairs).

In 2002, home help was organised in 59 percent of Hungary's settlements, but barely 2 percent of the over-60 population was covered by this form of assistance. Social catering is much more widely used and are available in 71 percent of settlements.[2] In 2002, 3.8 percent of households of persons over the age of 60 years took advantage of this assistance, which offers one hot meal a day.[3]

Forty-four thousand people over the age of 60 years (2 percent of the age group) receive some form of institutional care. Most of them, 85 percent, receive permanent placement in some social welfare institution. Another 5 percent of institutionalised elderly are housed in some sort of

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[2] Bácskay, Andrea: Forms of elderly care - basic social services. The elderly in Hungary, Hungarian Central Statistical Office, Budapest, 2004

[3] In 2003 some 44,000 seniors received home help, and 105,000 received social catering, giving a rate of 205.7 and 492.5 respectively out of every 10,000 persons over the age of 60 years.

inpatient facility, while 4 percent are in social welfare institutions that offer temporary placement.[4]

Appendix 2, Tables 2.4-2.6 contain background data.

The poverty risk among the elderly

Trends in the poverty risk can tell us the extent to which the pension scheme is able to prevent old-age poverty. Here we have to be aware that the minimum subsistence level determined in Hungary on the basis of objective need and the average per capita income are quite close to each other, and the gap between average income and minimum income is narrow because of the way incomes are differentiated (in recent years mostly upwards differentiation has been seen).

According to pension indicators[5] and national household statistics data, the poverty risk among the elderly has evolved a bit more favourable than the poverty risk for the whole of the under-65 (under 60) population. In the period under investigation, this was not triggered by more dynamic growth in pensions than in incomes for the economically active. Instead, it was caused by the contrast between the income fluctuation of the economically active age population subjected to the uncertainties of the labour market on the one hand, and the certain and predictable income from pensions on the other.

Examining the per capita net income, the over-60 population is 2 percentage points ahead of the nationwide average, which is in connection with the high proportion of dependants among the economically active population. The elderly0 are not behind in calculations of income per unit of consumption either - they are on par with the nationwide average. The only point at which the elderly are significantly behind the under-60 population is when comparing the incomes of elderly and young households that are identical in type.

In the past 10-15 years, the income status of pensioners showed somewhat of an improvement compared to families with children. This was despite the facts that during the 1990s the rate with which pensions were raised was slightly below the rate with which average incomes rose, that the relative income position of pensioners deteriorated compared to the economically active, and the purchasing power of pensions did not reach the 1989 level until 2003, which was later than earnings reached it. The underlying factor for this was a rising inactiveness rate, which pushed up the number of dependants per economically active person. This triggered the improving income status of pensioners calculated in per capita incomes, despite the deterioration in their relative income position.

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[4] Kapitány, Gabriella - Lakatos, Miklós: Major demographic specifics of the elderly population based on census data. The elderly in Hungary, Hungarian Central Statistical Office, Budapest, 2004

[5] The European Union's Indicators' Sub-Group of the Social Protection Committee (SPC ISG) established a set of pension indicators to enable comparisons of agreed common objectives. Some conform to the Laeken indicators while others offer a deeper insight into senior citizens and pensions. Data on this is presented in Appendix 1. Some figures come from EUROSTAT, but most were calculated from the Hungarian Central Statistical Office's Household Statistics database, using coordinated methodology.

Prior to the 1990s, the shift into retirement status meant a drop in living standards and poverty for many people. As of the 1990s, this was reversed, since the regime change was accompanied by a significant drop in living standards in which the income status of pensioners did not decline as sharply as it did for the economically active. Until 1997, the real value of pensions also dropped significantly[6], which resulted in a major deterioration in living conditions of pensioners, too, but the stable income offered by the pensions qualified as a relatively advantageous situation compared to the people of economically active age who supported children and were hit by mass unemployment.

According to a survey conducted by the Hungarian Central Statistical Office, income inequalities among the elderly are more moderate than the nationwide average. A large portion of retirees are in the middle (or higher) income decile, while the number of retirees in the bottom three and the top deciles is lower than their rate within the population. However, the fact that fewer people over the age of 60 years than their rate within the population are at the bottom of the income scale, among the very poorest people, does not mean that there are no clearly definable groups of elderly people who run a significant risk of poverty.

- One such group is the increasingly numerous group of elderly women living in single-person households, whose main source of income is their pension, which for women is 23 percent lower than for men. Single-person households are more common among pensioners than the nationwide average, and the bulk of them are made up of widowed women with low incomes. Fully 21.2 percent of single person households where the occupant is 75 years or older are poor.[7]
- Another and growing group is made up of pensioners whose specific ‘age-dependent’ needs - serious illness, need for nursing care, limited ability to manage activities of daily living (ADL) - are higher than average. Even if their income status is among the better, this group does not have the resources to maintain its previous living standards. There is a very serious risk of poverty among persons with chronic illnesses who do not receive free-of-charge medication under the medically indigent care scheme. This problem hit 287,000 households in 2002, which is about one-third of the 970,000 households where all members are seniors. The risk of elderly people living in small settlements is increased because this is where social services are least available.

Creating opportunities to maintain the living standards previously attained (objective 2)

The relative level of pensions is easy to see if we look at it as a proportion of the nationwide average net earnings. In 2003, the per capita monthly average amount of all forms of pension benefits was HUF 52,360, which comes to 59 percent of nationwide net average earnings. The rate for old age pensions is also around that, and was 35.8 percent for dependant benefits. In the past 10 years, the rate[8] for all pension benefits fluctuated between 56.3 and 61.3 percent. The

[6] Hungarian Central Statistical Office, Household Statistics 2002

[7] The older the person the greater the chance that he or she will live in a single-person household (among 60-69-year-olds the rate is 62 percent, while among the over-80s it is 91 percent). The poverty risk of single or widowed elderly women is 2.5 times higher than average. Hungarian Central Statistical Office, Household Statistics 2002

[8] At present, pensions in Hungary are not taxed. This is why the comparison was made with the average net income.

fluctuations were essentially triggered by pension increases in the given year, one-of-a-kind pension measures, differences in valorisation compared to previous years' earnings, and the composition of new retirees.

In the past ten years the rate of newly calculated pensions compared to net average earnings has fluctuated because of differences in the composition of new retirees. Pensions calculated and awarded in the early 1990s ranged from 54 to 57 percent, because more people retired with shorter periods of employment. After the retirement age was increased in 1997, during the years when a longer period of employment gave a person the option to take early retirement, the index increased, and for instance for old-age pensions determined and awarded in 2000 the indicator jumped temporarily to an average of 73 percent, while in 2003, it stood at 68.8 percent.

The base case considered when calculating theoretical replacement rates[9] does not feature the situation in Hungary for several reasons. The commonly accepted parameters and the 65-year-old retirement age are not typical. In 2003, the average retirement age for men was 59.7 years, while for women it was 58.6 years (the average period of employment was 37.7 years). The common parameters were valid for less than 0.5 percent of people who retired in 2003. In addition, these calculations give misleading results because of the pension bonus incentive to stay on the job. Among men, continued work can push up the pension by 6-18 percent compared to what it would have been originally, while among women, in an extreme case it can go up by as much as 60 percent.

In 2005, the net replacement rate in a typical case when a man with average earnings retires at age 62 years after 38 years of employment would be 83 percent if we include the 13th month pension (without the 13th month the rate would be 75 percent). Four versions considered typical can be used to illustrate the situation in Hungary. They are male (I.) and female (II.) pensions, retirement on minimum wage with minimum period of employment time (III.), and long period of employment with a break in the career course (IV.). In 2005, the rate is a high 86.6 percent for Case I., 71 percent for Case II., and 55 percent for Case III. These same parameters for 2050 yield a 3-7 percentage-point drop in the replacement rate. The interrupted career yields a lower replacement rate as a result of shorter periods of employment. Indexation rules result in a lower replacement rate for the tenth year of retirement.

An important component of income security for elderly persons is maintaining the real value of pensions once obtained, meaning long-term assurance that they maintain their purchasing power. In this respect, practices in the decade-and-a-half to two decades behind us were not truly consistent. In the ten years prior to the change in regime the increases in pension benefits were not uniform or systematic but were differentiated based on annual decisions, and were lower than the rise in the consumer price index. Following the regime change, the regular annual indexation of pensions became a legal requirement, to take place according to normative capitation rules, which, however, changed during various phases of the decade. At the same time, the regime change was a period of economic crisis, of sharply declining GDP and sinking real income, in which pensions did not retain their real value either. The drop in real value hit bottom in 1996,

[9] The version of SPC ISG methodology was jointly adopted as a basic scenario. Appendix 3 has more detailed information on this and on the four versions which are typical of the situation in Hungary.

when it was nearly 30 percent below the 1989 level. It returned to the 1989 level in 2003. (For more details see Appendix 2, Table 2.3/c.)

With fluctuating real values, pensioners found themselves in significantly different situations, depending on the year in which they retired. With differentiated increases, the lower pensions were generally able to retain their value, while the higher ones suffered a long-term drop in real value.

Swiss indexation, which calculates increases in consumer prices as 50 percent of the basis for increasing pensions, and increases in net average earnings for the other 50 percent, was introduced in 2001 and is expected to create a completely new situation in pension trends. On long term - assuming long-term growth in the economy and real earnings - the pension increase will remain steadily below the rise in earnings on long term. To transitionally mitigate, and to some extent correct, the effect of this trend, a 13th month of pension has been gradually under introduction starting in 2002, while supplementary surviving spouse's pensions have been increased to 30 percent.
An elderly generation of constantly growing numbers is expected to be able to enjoy retirement pensions for a longer period of time. Although Hungary is significantly below the EU average regarding life expectancy at birth (for women it is 4.5 years less and for men it is 6.5 years less), the difference is less for life expectancy at 60 and 65 years of age (for men the difference is 3.5 and 3 years, and for women it is 2.9 and 2.6 years, respectively).

Promoting solidarity (objective 3)

Intergenerational solidarity

An important goal of the pay-as-you-go system introduced after World War II was to offer pensioners a decent income insofar as circumstances allowed. It was via a significant expansion of the legal scope of the pay-as-you-go system that made it possible for many people to earn pensions in their own right under terms of eligibility that were easy to meet. Earlier contributions to the system did not create the basis for funding it, and people who are currently economically active are supposed to carry the burdens.

A recently published research project that studies the issue using retrospective age-group accounting (generational accounts) is an attempt to quantify the redistribution among generations.[10]

The study compares retiree careers typical of the different years with the contribution payments and retiree careers of the various years. It draws a balance of the two to investigate the question of which groups are net beneficiaries of the system and which have been net contributors. As its point of departure, the calculation began with the net balances of the various age groups in 2000.

[10] Gál, R. I. and Tarcali, G. (2003): Pension reform and intergenerational redistribution in Hungary. *The Economic Review* (Japan, *54,* 237-47.)
Note: For want of comprehensive data, the calculation was not able to take into account prospective entitlements acquired under the fully funded system prior to World War II.

Trends in the retrospective pension curves as well as of the contribution profile curves suggest that the system is maturing. The number of persons entitled to pensions and the average length of insurance periods they had accomplished have grown significantly.

The retrospective contribution and pension curves and the balance of the starting year were used to calculate complete net pension-life curves. The results are similar to international experience in showing a significant redistribution to the benefit of the age group that was first to enter the system. The gain steadily increased for those in the first roughly 20-25 years, then shows a continuous decline up until the people who are now 70 years old, though the balance is still positive. However, for all age groups born later, the system has been operating at a deficit. The biggest net contributor payers during their careers are the people born between 1940 and 1955, while for people younger than this, the net loss has declined continuously.

This same study investigated the effects of transfers among generations in the 1997 reform and drew the conclusion that the reform reduced the potential load on later generations while increasing that of the generations who are currently of economically active age (for more details see Appendix 2, Table 2.7.)

Moreover, in connection with intergenerational solidarity mention should be made of supplementary entitlements within the PAYG system that primarily affect inactive women and improve subsistence for low-income widowed women. Minimum income guarantees are examples of solidarity among the generations within and outside of the social insurance system.

Certain elements of solidarity can be discerned within the fully funded insurance system that has been operating since 1997. Despite the fact that this is a contribution-defined fully funded system, a unisex mortality rates are employed to reduce gender inequality. The system also contains several guarantee elements (such as a yield equalisation mechanism, which involves the placement of higher-than-expected yields into a yield equalisation reserve, and if the yield realised is below the lower limit of the expected yield zone, the individual accounts of the members are credited at the expense of the equalisation reserve fund.)

Solidarity among the elderly

The pension scheme brought about a redistribution of incomes based on social considerations, indicated by the fact that the dispersion in the amount of income of the highest and lowest 20 percents of distribution is more even in the over-65 population than it is among the under-65s.

Currently, there are significant redistribution mechanisms that operate to reduce pension incomes (degressive scale, degressive calculation of average earnings, inclusion of low incomes with a close to 100 percent replacement rate). Starting in 2013, when new pension calculation and determination rules go into effect, these effects will be terminated. However, preferential rules to reduce the effects of shorter periods in employment due to raising children, caring for a sick family member, and unemployment will remain in effect within the social insurance system. The fully funded insurance system, by its very nature, does not contain any such elements of solidarity.

The effects of internal solidarity mechanisms in the pension scheme are significant when it comes to reducing gender inequality, but this will change as differences existing upon retirement will be gradually disappearing from the system. The new rules for determining pensions will not make corrections for differences between low and higher earnings.[11]

It should be mentioned that Prior to 1993, there were compensation mechanisms which did more to restore the depreciation of lower pensions. Practically speaking, pension depreciation is most typical of the oldest retirees who do not live on low pensions.

3.1.3 Future prospects and policy challenges

The future income trends of elderly persons should be studied in the framework of demographic processes and in the light of expected improvements in the employment indicators, but in the perspective of the current employment profile of future pensioners. Clearly, it is significant that the effects of the pension reform initiated in 1997 are seen gradually and that the fully funded insurance system which will mature by 2060-2070 is going to have an increasing weight.

The Hungarian demographic old-age dependency rate (people over 65/people 15-64) is currently 3 percentage points more favourable than in the average of the EU-15, and projections to 2050 indicate that it will be five percentage points better. The index is expected to increase from 22.4 percent in 2003 to 48.3 percent in 2050 (the corresponding figures for the EU-15 are 25.2 percent and 53.2 percent, respectively).

The pension dependency rate - that is, the ratio of recipients of old age, invalidity, and dependant pensions compared to contribution-payers - is also developing unfavourably. It would go up from the 62.3 percent in 2000 to 84.8 percent in 2050, calculating with a 62-year retirement age.

With the deteriorating demographic and economic activity trends, maintaining the current pension level will be a challenge, even if we consider the effects of the 1997 pension reform, the growing rate of people within the fully funded insurance system and improvements in the employment rates. In the time to come, the latter half of the 2010s and the 2030s promise to be the tightest.

Projections indicate that the rate of the average pension level compared to the nationwide average earning level will drop by about 8-10 percentage points by 2050 as a result of the combined indexation for persons retiring from the social insurance system. The deterioration will be about 3-5 percentage points for people retiring from the mixed system (the latter will make up the bulk of retirees.)

Another challenge is differentiation within the average pension level. This particularly affects very elderly singles including women, people already over the age of 50, and groups vulnerable to being driven off the labour market including people with obsolete skills and the pension

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[11] The system will, of course, retain a measure of “classical” solidarity (the solidarity of men towards women) in which women will not pay higher pension contributions or receive lower pensions for the same insurance payments despite the significantly longer expected period of retirement.

disadvantage this entails. Among women, certain estimates suggest that atypical insurance careers will increase significantly and that groups which today are unskilled and in the low income category, will have even lower pensions. Unemployment, which can occur more often and/or last longer, will result in shorter periods of insurance and a higher risk of low pensions.

3.1.4. Strategies for securing future adequacy

Concerns regarding assuring an adequate pension level on long term have been voiced for some time in debates to transform the pension scheme. Despite a variety of different positions, there is wide agreement that the measures

- will have to increase the relationship between contribution payments into the system and benefits received as well as the responsibility of the individual also within the social insurance system (reform rules that take effect as of 2009 and 2013 will be significant steps forward here);
- will have to do whatever they can to include the payment of insurance contributions on incomes currently outside the system;
- will have to respond more decisively to the labour market situation and will have to reduce the widespread illegal and semi-legal (‘black and grey ’) economies;
- will have to offer more powerful incentives to keep people in the labour market for a longer time (in 2004, the bonus for staying on the job after reaching retirement age was increased);
- will have to boost people’s prudential concern and the idea of individual responsibility (at present one-third of the insured persons has savings in the voluntary pension scheme, which will be a roughly 8-10 percent increase in pensions on average);
- will have to continue to operate support and incentive programmes for groups forced off the labour market (some of which have been introduced in past years, others of which are in the pipelines or are about to be introduced. Appendix 4. has more information on them);
- will have to accelerate the lifelong learning programme, support NGO initiatives of model value for older persons, and adjust adult education to market demands.

Future minimum wage guarantees in a mixed system:

Under current rules, the minimum pension will be cut out of **the social insurance system** as of 2009, and its function will be transferred to the social benefits system. From that time on, the guarantee of minimum income for the elderly will operate in a combined system:

- low pensions awarded will be supplemented to reach the level of a social minimum (the arrangement has not yet been decided);
- the old-age allowance system will have to be reinforced, for instance, among the older people (10 years over retirement age) a heightened means-tested amount will have to be provided irrespectively of spousal income.

Each year, pension increases will take place in accordance with Swiss indexation. On long term this will result in a relative decline in the pension level as already mentioned, but it will offer better conditions than simply retaining purchasing power.

In the mandatory fully funded insurance system, elements that guarantee savings and that the value of the services are retained have been built into the system for both the period of accumulation and of service provision. During the time the annuity is paid, there are rules and specifications that guarantee the level of benefits including safety specifications when the annuity is determined, as well as for the indexation. No set minimum guarantee has been planned for the amount of the annuity, for the annuity system for the elderly will operate in combination with the mandatory system.

Expected trends in future pension levels

The reform has targeted a pension level of about 60 percent of net average earnings; that was roughly the pension level prior to the reform. However, in the future, the only people who will be able to count on sufficient pensions will be ones with adequately long periods of employment (close to 40 years), who have paid contributions and membership fees over a long period of time. Therefore it is an important issue to achieve a high employment level for otherwise old-age income inadequacy and poverty will be reproduced and become a mass phenomenon.

There is a serious problem in that currently a very high number of people pay contributions only on a minimum wage. If this becomes a permanent phenomenon it will significantly raise the risk of future poverty. Several studies have warned of this risk.[12] In 2003, over 30 percent of contributors made payments on minimum wages (the proportion of self-employed persons and employees within this group was about equal). Even more serious is that a significant portion of people whose main economic activity is private farming stay outside the mandatory pension insurance system (their taxable income to serve as the basis for contribution payment is insufficient).

Preserving the value of pensions

Within the social insurance system pensions are raised annually using Swiss indexation (50 percent of raise is based on price increases and 50 percent on earnings increases). On long term, this will result in a gradual decline in pensions in proportion to earnings. The effects have been reduced by the gradual introduction (from 2003 to 2006) of the payment of a thirteenth month of pension. The law on mandatory fully funded insurance system calls for ensuring the adjustment of a rate that corresponds to the indexation of social insurance pension benefits.

3.2. Financial sustainability of pension systems

3.2.1. Policy objectives

The prime objective of the government in connection with the financial sustainability of the pension scheme is to maintain sufficient resources to cover an adequate level of benefit provision

[12] Augusztinovics, Mária, scientific advisor to the Institute of Economics of the Hungarian Academy of Sciences: Population, employment, pensions. In: Közgazdasági Szemle Vol. 52. May 2005.

on short and long term. The primary source of financing is revenue from employers and insured persons that take the form of pension contributions. If need be, they are supplemented from the general revenues of the central budget. When setting the rates of contributions, the fundamental goal is that the burden on the economically active should not be unjustifiably large and that the payments for economic actors should not be unfair. Appropriate incomes have to come from increasing employment although cutting back the semi-legal and illegal ('grey and black') economies on long term is also important. (**objective 4**)

3.2.2. Current situation

Expenditures on pensions are financed from the social insurance funds, the Pension Insurance Fund, and, to a minor extent, from the Health Insurance Fund.

In 2004, total expenditure on pension benefits amounted to HUF 1,925 billion based on preliminary factual data, which is 9.52 percent of GDP. Of this, HUF 1,690 billion (8.37 percent of GDP) came from the Pension Insurance Fund (which includes HUF 20.3 billion from the central budget as reimbursement for pension expenditure), and HUF 235 billion (1.15 percent of GDP) came from the Health Insurance Fund (Category III invalidity pensions for people below retirement age and the derived dependant benefits).

The most important sources of revenue to the social insurance funds are the contributions made by employers and employees. The 18 percent pension insurance contribution paid by employers goes into the Pension Insurance Fund. The rate of contribution to be paid by the individual is 8.5 percent or 0.5 percent, depending on whether the individual is insured only by the social insurance system or is in the mixed system. Employees are only required to pay contributions on income up to a certain level (in 2005 that level was over three times the average earning). There is no ceiling on the amount after which the employer is required to pay contribution. In 2004, revenues from contributions covered 76.4 percent of Pension Insurance Fund pension-related expenditures. The rest came from the central budget.

There are two basic reasons for the inadequacy of revenues from contributions, above and beyond the evasion of contribution payment. The largest item that does not enter the system is the employee contribution that members of fully funded insurance schemes (currently 62 percent of insurees) pay into the private pension funds (8 percent of the basis of contribution) instead of into the Pension Insurance Fund. On long term, the maturity of the mixed pension scheme will balance out this loss of contributions, since the social insurance system will provide persons insured under the mixed system with only 75 percent of the amount that people retiring only from the social insurance system will receive. But, for a long time to come, the mandatory fully funded insurance system will not substantively reduce the burdens on the social insurance system, while the loss of revenue is immediately apparent. The central budget has guaranteed that it will provide a subsidy to reimburse the Pension Insurance Fund for the transitional shortage caused by the pension scheme reform. This subsidy to cover the loss in revenue from contributions - which is foreseen in the Fund budget each year in a planned manner - amounted to HUF 186 billion (0.9 percent of GDP) in 2004.

The other reason for the inadequacy of revenues from contributions is that the combined amount of contribution payments of employers and individuals went down from 31 percent in 1998 to

26.5 percent in 2003. The amount of the employers' contribution was reduced to cut the extremely high cost of wages. For this reason, the central budget is also covering this portion of the Fund shortfall, which is in addition to the amount triggered by the introduction of the mixed system. The Fund budget includes other subsidies from the central budget. In the Fund's budget, central budget subsidies include transfers on behalf of various maternity support schemes (childcare fee, childcare allowance, child raising benefit), since the government has agreed to pay the employers' contribution portion on these benefits (amounting to HUF 22 billion in 2004). If we do not include this amount or the budget coverage of loss of income to the Fund because of the introduction of the mixed system, the Pension Insurance Fund deficit would have been HUF 177 billion (0.9 percent of GDP) in 2004, which is roughly equivalent to employers' contributions of about 3.1 percentage points. The Fund has no reserves or substantive assets, so inflow from property management is negligible.

There are but limited opportunities to increase revenues to the Pension Insurance Fund as earnings increase and as the black and grey economy is legalised. Increasing the amount of the contributions is not a realistic alternative for employment policy reasons. Other factors that keep inflow from adequate increase are avoidance of contribution payments, a low level of payment discipline, and the illegal and semi-legal economies.

3.2.3. Future prospects and policy challenges **(objectives 6 and 8)**

The exploration of future prospects relies on a pension projection which was prepared in October 2004 on the basis of latest domestic demographic and employment projections and submitted to Parliament as an appendix to the 2005 budget.

According to the projection, the proportion of employed persons within the population of working age (over the age of 18 years and younger than retirement age) will go up from the 63 percent in 2004 to 71 percent in 2050. Due to the calculated improvement in the employment rate, the ratio of pensioners to employed persons will deteriorate less than will the old-age dependency ratio (it will go up from 62.3 percent to 84.8 percent).

According to a projection of pension-related expenditure financed by the Pension Insurance Fund, the expenditure will decline in trend from 8.3 percent of GDP until 2010. At that time, social insurance pension expenditure is estimated to amount to 7.2 percent of GDP, with services expenditures (annuities) offered by the mandatory fully funded insurance system still amounting to a very low level (0.1 percent of GDP).

The effects of the introduction of the fully funded insurance system will begin to become significant on the expenditure side from the 2020s onwards. From this time on, an increasingly significant portion of new retirees will retire as members of the mixed system and as such, will be entitled to reduce benefits from the social insurance system. According to the projection, in 2050, the fully funded insurance system will free the Pension Insurance Fund of pension-related expenditure equivalent to 1.8 percent of GDP (compared to what its costs would have been if the reform had not been introduced). In all likelihood, the gross pension expenditure of the Pension Insurance Fund is not likely to exceed the 2000 level of 7.6 percent of GDP in 2050. At the end of the period, the combined amount of pensions (annuities) paid out under the mandatory system will amount to 9.8 percent of GDP. The projection indicates that the fully funded insurance system will pay out 0.4 percentage points higher benefits than the amount it saves the social insurance system. At that time, the majority of the 2.8 million retirees (2 million people) will receive their benefits from the mixed system.

As far as revenues are concerned, the fact that members of the mixed system will be paying reduced contributions to the pay-as-you-go system will be defining. For several decades this will cause a surplus deficit that will grow steadily until the 2020s, as a growing portion of the economically active population joins the fully funded insurance system as members. The other most important revenue-reducing effect is that the absolute number of employees will decline, due to demographic causes. Later, the effects of the reform will become tangible on the expenditure side. The mixed system is expected to fully mature between 2060 and 2070. At the same time, it is important that during the same time, savings (accumulation) will arise in the fully funded insurance system the amount of which equals the transitional deficit in the Pension Insurance Fund.

The expenditure and revenue effects should trigger somewhat of an improvement in the Pension Insurance Fund’s primary balance (inflows from contributions minus expenditure for pension-related benefits) up to 2013, but from that time on, the deficit will increase continuously. The rate with which it increases will be an accurate reflection of demographic flows and trends in the dependency rate. This, essentially, will be behind the deterioration in the balance starting in the latter half of the 2010s and increasing significantly in the 2030s. By 2050, the deficit calculated on the basis of gross pension expenditure is projection to come to 2.8 percent of GDP, while the deficit calculated for net expenditure will be 1.7 percent of GDP. This essentially coincides with the 1.8 percent involvement of the central budget in 2004. (**objective 6)**

At the same time, according to the 50-year-projection, the mixed indexation of pension increases will reduce the rate of net pensions compared to net average earnings on the national economy level from the 61.5 percent in 2004 to 52 percent in 2050 for persons receiving benefits solely from the social insurance system. For people within the mixed system, the relative deterioration in pensions will partly be balanced out by the higher benefit received from the fully funded insurance system. Thus, model calculations indicate that they will receive 58 percent of average earnings. In 2050, over two-thirds of pensioners will be receiving benefits from the mixed system, so no exceptional adequacy problems are forecast on average level. The models were designed with yield rates exceeding the wage increase rate by one percentage point. A 1 percentage point increase in a yield rate can push up the pensions of people just beginning to work by 5-10 percent.

The balance of the mandatory fully funded insurance system for the whole of the projection period promises to be positive. In other words, annual yields from membership fee payments and invested assets will cover expenditure and we should still see fund accumulation grow continuously. The first year that fully funded insurance system annuity expenditures exceed member contributions will be in 2050. According to calculations, in 2050, the assets of private pension funds will reach 46 percent of GDP (in 2004 they came to 3.7 percent of GDP).

Pension expenditure of the mandatory pension insurance system - including expenditure financed by the Health Insurance Fund - is expected to drop from 9.3 percent of GDP in 2003 to 8.8 percent of GDP in 2050. The decline will be the result of the reform, which should be able to completely counterbalance the unfavourable effects of demographic trends. The rise in the number of elderly people should be expected to increase expenditure by 45 percent. Operating against this factor is that the ratio of pension recipients to all elderly people declines, which will reduce expenditure by 17 percent overall. Within that, the tightening up of entitlement criteria (continuing to raise the retirement age as announced, and stricter conditions allowing early retirement) should result in a 7 percent improvement, while the assumed decrease in the number of invalidity benefits and a decrease in the proportion of persons entitled to old-age benefits, due to labour market trends, will result in a 10 percent improvement. The biggest influence (22 percent) will result from a reduction in the level of benefits. In 2050, over two-thirds of retirees will receive benefits from the mixed system (decreased benefits at a proportion of three-quarters) while Swiss indexation will cut back on the overall level.

The projection model calculates with a 7.4 percentage point improvement in the employment rate. If employment is less favourable than anticipated and rises by only 5 percentage points, by 2050 the deficit in the Pension Insurance Fund (calculating with gross pensions) will be 3 percent of GDP instead of 2.8 percent as anticipated.

In 2005, 0.6 percent of the GDP will be used for regular pension-type social benefits. It is expected that by 2010 this number will decline to 0.5 percent (indexation which by the way equals the rate of pension increase is below the GDP growth rate.)

In 2005, it is expected that overall state budget expenditures will amount to 47.4 percent of the GDP. By 2010 the projection indicates a drop to 43.8 percent. The rate spent on pension benefits within the state budget expenditures will not change significantly until 2010.

At present, 32 percent of employees are members of one or another of the 75 voluntary supplementary retirement funds. In 2004, the average membership fee payment amounted to 3.6 percent of gross earnings, about one-third of which was paid by the member and two-thirds of which came from the employer, pegged to the specific member. Given an average of 30 years of membership fee payment to the voluntary pension schemes, this can result in a supplementary pension of 8-10 percent of earnings. (**objective 8**)

As far as the investments of the fully funded insurance system and the voluntary supplementary pension funds are concerned, laws include detailed safeguards. There are investment limits on some, more risky asset categories. In addition the funds and the managers of assets and deposits are governed by rules of prudent operation for both personnel and assets. There are also conflict of interest rules in place (for instance, the law requires that separate actors manage assets and deposits). Funds require a permit from the Hungarian Financial Supervisory Authority (HFSA), a financial market watchdog. HFSA regularly conducts on site investigations. It also regularly studies reports sent to it as mandatory, and conducts a variety of investigations into reports of specific measures. HFSA has a broad arsenal of tools to terminate and sanction operations that do not comply with regulations. (**objective 8**)

3.2.4. Strategies for tackling the financing gaps

The following measures are in place to support the objective of a sustainable pension scheme:

- The rule calling for the regular annual increase in pensions guarantees that the real value of the pensions will increase steadily, while a growth rate set below that of GDP will reduce the hazard of runaway growth.
- The gradual rise in the retirement age first announced in 1997 will continue until the full increase is achieved, in 2009.
- As of 2009, the stringent conditions set by law for allowing early retirement will be in place. At present, a reduced pension will be granted after a period of employment of 33 years and a full pension after a period of employment of 38 years upon reaching age 57 years for women and upon reaching age 60 years for men. As of 2009, the eligibility criterion concerning period of employment will be increased to 37 years for a reduced pension and 40 years for a full one, and the minimum age will be 59 for both genders, taking due account of accrued rights.
- When calculating average earnings on which pensions are based, the period considered increases year after year, since the entire earning attained between 1988 and the time of retirement are to be taken into consideration.
- Elements in the pension scheme that offer incentives to keep working can improve the financing of the system by reducing the number of years during which a pension has to be paid out. In 2004, the pension increment (bonus) following the attainment of retirement age has gone up from 3.6 percent/year to 6 percent. Another envisaged change acting as an incentive to stay on the job involves changing the contributions period scale foreseen for 2013, so that the scale shifts from one that is essentially degressive to one that is linear.
- The sustainability of the social insurance system will be improved by the fully funded insurance system in which some of the benefits will depend on the amount of capital invested in the fund. These services will be covered by earlier accumulation which will significantly reduce the dependence of the pension scheme on current inflow, that is, on demographic and employment trends.
- The future expenditure of the social insurance system will be reduced by the fact that when the mixed system got underway, many insured persons, who had a significant amount of contribution periods, took the voluntary decision to switch to the mixed system. In all cases, people retiring from the mixed system will receive reduced pensions (25 percent less) from the social insurance system, independently of the number of years of contribution payment they had made exclusively the social insurance system before they switched. This means that people who were not at the start of their careers lost one-fourth of their pension entitlements, which appears in the social insurance system as a saving. (However, this is not necessarily a loss to the individual, because given an average yield expectation - after a sufficiently long period of making membership fee payments - the private pension insurance service will compensate them for the loss. Older private fund members, who retire before 2012 with less than 10 years of membership in a private fund, may instead request full social insurance pension benefit, on condition that they transfer the funds they accumulated in the private fund back into the social insurance system when they retire.)

Achieving a high level of employment, labour market reforms (objective 4)

The current employment situation

The dominant features on the Hungarian labour market of the early 1990s were a dramatic decline in employment and economic activeness, a sudden leap in unemployment, and a restructuring of labour by main sectors and occupations. By 1994, losses of markets and a decline in domestic demand cut economic performance by 20 percent and the number of people in employment by 25 percent.

Particularly noteworthy among the changes in the economy were the transformation in the ownership pattern and the mushrooming of private businesses. A majority of the state-owned businesses underwent bankruptcy and restructuring proceedings, and when privatised the large companies were broken down into small ones. When the large state-owned companies underwent a process of corporatisation, the process involved mass dismissals. The increase in small businesses was only partly able to compensate for the jobs that were lost. The privatisation in general was followed by organisational transformation and technical modernisation, and these again triggered redundancies.

In February 1993, the number of registered jobless persons peaked at over 700,000 people. The unemployment rate made public by the Hungarian Central Statistical Office exceeded 12 percent (See Appendix 2, Table 2.11.).

Not all of the people driven off the labour market became unemployed for nearly half become economically inactive instead. Labour regulations assisted in this process (with early retirement, and pre-retirement pensions). This was the most humane way of assisting people forced off the labour market during a time when countless jobs were lost.

The drop in employment and in the economically active population bottomed out in 1997. At that time only 57.6 percent of the 15-64-year-old population was economically active and only 52.5 percent was employed. Development began to accelerate as of 1997, with the GDP growing by 4-4.5 percent a year from then on.

A rise in employment followed the stabilisation and beginning growth of the economy, although with a bit of a delay, a measure of fluctuation and a lower level. In 2000, the employment rate was 56.3 percent and the activity rate stood at 60.1 percent. (Appendix 2, Table 2.11/c) Following the turn of the millennium, the growth rate halted, generating significant changes on the labour market, shifts and fluctuation in the workforce composition, which has caused employment tension in various regions. This is the background to Hungary’s low level of employment, which is well below most of the countries of Europe. It has been an obstacle to economic growth, to the country’s ability to adjust to change; it keeps budget revenues within narrow limits while increasing its burdens, especially expenditures in the social insurance realm and on social benefits; it also limits opportunities to reduce taxes on long term and increases the risk of social exclusion.

Basically speaking, labour market factors generated the low employment rate, but other contributors have been the low retirement age, the population’s poor general state of health, and the comparatively wide range of income replacement benefits - including early retirement - for people who lost their jobs or consider their jobs to be at risk.

One specific of the Hungarian situation is that the low employment level (56.8 percent in 2004) goes hand in hand with a comparatively low unemployment rate (6.1 percent) and a high economic inactiveness rate (39.5 percent). There is a considerable proportion of ‘black’ and ‘grey’ work.

The gap between Hungary and the EU-15 is particularly large when it comes to the employment of older people. The difference in the 55-64-year-old category is about 13 percentage points (Appendix 4.) This, too, is connected to the lower retirement age. In recent years there has been an improvement in the employment rate of the over-50s, partly because of the gradual raising of the retirement age and partly because of improvements in qualification levels.

Trends in unemployment

In the period of radical economic transformation that followed Hungary’s regime change the number of registered jobless persons rose from 100,000 to 700,000 between 1990 and 1993. Then, it dropped down to about half that figure by 2002 (the accounting system changed, but this does not affect the trend). In the past two years both the number of unemployed persons and the unemployment rate have increased. The sharp economic restructuring has resulted in a transitional increase in the number of people who are out of work. (Appendix 2, Tables 2.11/c-d)

Labour market prospects

According to projections of the Ministry of Employment and Labour, if employment targets are met, the workforce will increase to about 4,050,000-4,060,000 by 2006, and to 4,300,000-4,320,000 by 2010. No real change is expected in the number and rate of unemployed persons; if employment grows more rapidly, then the unemployment rate is likely to decline by some tenths of a percentage point. The rate of economic activeness (expected to be 62 percent in 2006 and 66-67 percent in 2010) will be similar in rate to the rise in the employment rate (an average of 0.8 percent/year).

Female employment is expected to increase very slightly more rapidly than that of men. By 2010, the female employment rate may rise to 57 percent, while the male rate will be 69 percent. The employment rate of older workers (55-64) will rise significantly, going up from the current 29 percent to 33 percent by 2006, and to 37 percent by 2010.

Appendix 4 contains measures that will influence the labour supply and demand.

The 50-year projection defines the economically active age group with Hungary’s retirement age as the upper limit, not age 65 years, and age 18 years, not 15years, as the lower limit. Therefore, the calculations given under Point 3.2.2. show a nearly 8 percent improvement in employment rate by 2050. Working with the 57 percent employment rate calculated for the 15-64 age group, the projection to 2050 is a 65 percent employment rate, which is below EU targets (Appendix 2, Table 2.10.)

Measures to help people stay on the labour market (objective 5)

Opportunities within the pension system for leaving the labour market prematurely

In defence against growing unemployment following the regime change, two opportunities for early retirement were designed. One is early retirement which allows people to retire younger under a scheme where the employer pays the former worker's pension until he or she reaches the age entitling him or her to a social insurance pension. This period was set at a maximum of five years. The other opportunity came after a person had exhausted unemployment benefits. If the person had only three years to go to reach retirement age, he or she could receive a pre-retirement pension, financed by the Labour Market Fund. This exit-route was terminated in 1998. miners' pensions and artists' pensions are available for a very limited circle of people in these professions, allowing them to retire significantly earlier than official retirement age. These pensions were established for employment policy reasons and at present there are few such pensions. While they accounted for one-quarter of the pensions granted in the early 1990s, their number does not reach 4 percent (4,000 people) of the newly determined pensions each year.

In addition to health status, employment difficulties do also play a significant role in the high number of invalidity pensions. There has been a minor decline in these numbers (in 1991 there were 66,000, while in 2003 there were 52,000), but the growth has been significant when compared to the overall number of pensions determined and awarded in own right in the given year (in 1991 it was 34 percent and in 2003 it was 50 percent). A major factor triggering this change in proportions has been the raising of the retirement age combined with the people who escaped joblessness by retiring in the early 1990s, because the actual number of people retiring in a given year has dropped by nearly half since 1991 (193,000 persons in 1991 and 104,000 in 2003).

One opportunity for early retirement in the social insurance system is known as pension eligibility based on reaching a certain age, which allows people who have worked under particularly hazardous conditions to retire at an earlier age to a full pension. This form of lowered eligibility age for retirement still exists, allowing about 5,000 people a year (5 percent of new pension awards) to receive pensions 3-3.5 years below official retirement age.

Another form of early retirement is early old-age pension, as described in Point 3.2.4.

Before the retirement age was raised, the vast majority of people chose to retire when they reached retirement age or when they were slightly above it (retirement age plus working through their notice period). This retirement as slightly over official retirement age was counterbalanced by the various early retirement schemes, which ended up bringing the male retirement age down to 1.2 years below the official line and the female age down to 0.4 years below the official age.

Data for 2000-2004 has been significantly influenced by the increase in the retirement age and the introduction of the early old-age pension (Point 3.2.4.).

An analysis of data on the effective retirement age shows that the opportunity of early old-age pension has had the strongest influence. The vast majority of retirees have retired within a very short time after reaching the earlier eligibility age allowing them full pension on retirement. In 2003, 90 percent of old-age pensioners retired on this scheme, before reaching official retirement age.

Among men, the effective average age of retirement fluctuated slightly at around the age of 60 years between 2000 and 2004. Very few retired at ages older than the earlier eligibility age for pension. Some, however, did not take advantage of the entire period available to them; others could only retire upon reaching the age eligibility applying to them (61 and 62 years respectively) because of a lack of sufficient periods of employment, and still others, not having completed enough periods of employment to become eligible for a pension at all, took, or were forced to take, the decision to continue working beyond usual retirement age for one or more years. However, this was balanced out (in some years it was minimally overbalanced) by special retirement opportunities (pension based on lower eligibility age, early retirement, miners' pensions). The number of persons using these options is low, significantly lower than in, for instance, 1995.

Data for women in 2000-2004 was far less consistent than for men, although here too, the earlier eligibility age played a dominant role. The data, which appears to reflect "two steps forward, one step back" does illustrate a rising trend, but it is not a smooth and steady one. The reason is that during the period under investigation both the regular retirement age and the early retirement age were rising, and they were doing so in alternate years. In 2000, 2002, and 2004 the regular retirement age rose, while in 2001 and 2003 the age of early retirement got higher. Specifics of the various years are in Appendix 5.

Among women, the rising eligibility age for early retirement, going up in alternate years, and the rising applicable regular retirement age played the dominant role in determining average age at retirement, and this is what triggered the "zigzags" in the system. The earlier eligibility age was not raised again after 2003 so it is expected that the average age at retirement for women will become stabilised at around age 57 and 58 years.

The aggregate data (men and women together) was strongly influenced by the fact that there were significant differences in the numbers of men and women retiring from one year to the next, triggered by the rise in eligibility age for retirement.

Effective average ages on retirement were 2-3 years below the EU average, but life expectancy upon reaching retirement age in Hungary is also 3-4 years below the average for the EU-15, so further substantive increases in effective ages upon retirement are only a realistic option if life expectancy on retirement increases in parallel.

It also needs to be considered that as of 2009, the opportunity for early will get tighter, while retirement age will be a uniform 62 years, which will automatically increase effective retirement age for women by 2-3 years. It is not expected to increase for men. The uniform rules will allow them to take early retirement one year sooner than age 60, which was retirement age before it was increased, so it is not unlikely that the effective age upon retirement will be lower by some months for men.

Coordinating retirement and income generating activities requires further study. Currently, old age pensions and old-age-type pensions may be accessed without having to become economically inactive. This acts as an incentive to some employees, who are counting on staying on the job, to access early retirement while continuing to engage in income generating activity. It would be expedient to revisit and modify regulations so that they do not encourage the earliest possible access to pension benefits. Since pensions can be accessed while earnings continue, the trends in effective ages at which persons leave the labour market is not relevant from the point of view of the sustainability of the pension scheme. That figure does not take into consideration whether the person is a beneficiary of pension or not.

Improving activity of the older generations could be promoted if entitlement to a pension were not a disqualifying criterion for receipt of unemployment benefits. A change here would not force a person of 40 or 50 years with reduced working ability or a woman of 57 years entitled to an early retirement pension to apply for a pension on becoming unemployed, and instead could be given an opportunity to find another job.

The sustainability of public finances (objective 6)

What increases in revenues and reduction in expenditures could be considered in order to maintain balance?

On both short and long term, increasing incentives to pay contributions and restructuring some of the pension plans could lead to a reduction in the deficit of the social insurance pension scheme.

We need to revisit the benefit plans with eligibility age below the retirement age, such as pension with lower eligibility age, invalidity pension. The goal of revisiting these systems is to change entitlement and financing conditions, to make access and cost-bearing rules fairer. The process of revisiting these plans may begin to lead to savings on medium term at the earliest.

On the revenue side, an increase in incentives to pay contributions is the primary means of contributing to financing balance. Therefore, in both schemes of the statutory pension system, it is a fundamental goal that benefits be granted in coordination with the amount of contribution paid. The fully funded insurance scheme meets this requirement because of its nature, and correction of rules operating against this in the social insurance scheme is underway. Shaping the rules that encourage payments will also promote an increase in the efficiency with which contributions are collected and will be able to draw unreported income into the system, too.

Fair balance between the active and the retired (objective 7)

Researchers have calculated[13] that the measures taken will reduce internal imbalances between generations of retirees who are already in the system. In addition, as the retirement age goes up

[13] Gál, R.I. and Tarcali, G. (2003): Pension reform and intergenerational redistribution in Hungary. The Economic Review **54**, 237-47.

and reform measures begin to exert an influence, a significant portion of the net loss to generations not yet born will disappear. Most of the costs will be borne by the economically active generations already living, and to a lesser degree the retirees will be worse off because of the Swiss indexation. Of the reform measures, Swiss indexation and raise in retirement age will have the most significant impact, and mandatory participation in the fully funded insurance scheme will also improve balance considerably. The linear rule and degressive income calculation will cancel each other out, so it will not influence the intergenerational sharing of the burden. (for more details see Appendix 2, Table 2.8.)

Achieving greater efficiency in the fully funded insurance scheme (objective 8)

The following measures are planned with a view to promoting implementation:

- The rules for annuities provided by the mandatory fully funded insurance scheme have to be defined in greater detail. When doing this, priority has to be given to providing information to members on the conditions for receiving expected annuities. It will be necessary to tighten up the elements of the rules of benefit determination which increase the security of the provision of annuities.
- To cut the costs of private pension funds, it needs to be ensured that competition between fund service providers is not limited. In this context, it needs to be reviewed the applicability of monitoring rules and conflict of interest regulations.

There have been some successful steps taken in achieving transparency and competition in a number of areas. One of them should be mentioned that are the detailed regulations setting the requirements for publishing private pension fund yields.

3.3 Modernisation of pension systems in response to changing needs of the economy, society, and individuals

3.3.1. *Adequacy gaps caused by insufficient adaptation of pension systems to labour markets and employment patterns* **(objective 9)**

A general objective is to make it possible to obtain an adequate pension in all forms of employment and with changing types of employment.

Currently, irrespectively of the form of employment (employee, agency contract, fee for services, etc.) mandatory insurance covers all taxable income from work if the person earning it makes at least 30 percent of the minimum wage in the given month. Private entrepreneurs must pay a contribution at least equivalent to the minimum wage and most do pay that minimum. People who do not have taxable incomes from work (for instance: farmers who produce for their own consumption) may conclude voluntary agreements to pay a contribution equal to what one would pay on a minimum wage. Day labourers may purchase so-called “public contribution coupon” to establish entitlement in both mandatory systems.

Atypical forms of employment are not obstacles to gaining entitlement to pensions. For instance, the period of insurance of part time work is fully taken into account as period of employment from the point of view of meeting the eligibility criteria, irrespectively of the amount of wages received.
However, far more typical than atypical forms of employment is a low-income job, which results in a low pension level in both schemes of the statutory system. In the fully funded insurance scheme a lower payment into the system triggers a lower annuity. In the social insurance system, the low income has an unfavourable influence on the pension if the low income was earned during the years which are taken into account as the basis for calculating the pension. Incomes earned after 1987 (the year the personal income tax was introduced) are counted as the basis for calculating the pension. Up until 1992 the best three years of the last five worked were considered, and after 1992 it was the last four years, increased by one year with each passing year. The result is that any person who become unemployed in the years following the regime change and, for instance, was forced to become self-employed in the few years prior to retirement, paying a contribution on minimum wage level, suffered a significant loss of his or her potential pension.

Once it reaches the level of lifetime earnings, the social insurance system will consider the fair pension base. In the meantime, a transitional rule could alleviate tension.

When people pay contributions below the minimum wage level - another feature of atypical forms of employment - the payments into the system are prorated to the minimum wage when calculating pensions, and the proportionate period of employment is recognised when calculating the rate of pension. This rule is valid for contributions for years following 1996. For persons who have permanently paid below minimum wage (contract workers working out of their homes, some part-time workers) the period of employment that may be taken into account for pension calculation is reduced proportionately. For instance, a person who worked 20 years and paid contributions on half of the minimum wage will receive a pension on the basis of an insurance period of 10 years. This is fair from the point of view of insurance but it results in a situation whereby the number of retirees requiring income supplementation on social grounds will increase as atypical forms of employment become increasingly widespread.

The rules of the pension system do not act as obstacles to mobility within the country because there is no regional differentiation, and the general social insurance system recognises the periods of insurance that people accumulated within various occupational plans (armed forces, mining, artists). Rights accrued under the fully funded insurance scheme are not linked to any particular workplace or occupation, and payments may be freely transferred from one pension fund to another.

Mobility from one country to another does not result in any disadvantage with regard to Member States in the European Economic Area with the application of Regulation (EEC) No 1408/71 on the application of social security schemes to employed persons, self-employed persons and their families moving within the Community, and with regard to countries with which Hungary has concluded bilateral social policy or social security agreements.

On the whole, the changes in pension rules made since the regime change and which are in the process of implementation, have promoted the ability of the pension system to adapt to changed employment patterns. The obstacles to the spread of these forms are not pension-induced. The problem is more that pension entitlements are for lower amounts based on the lower incomes generally attainable through atypical employment.

3.3.2. Gender equality and the gender impact of pension systems **(objective 10)**

Differences in the status of men and women

The status of women and the position of retired women within the pension scheme are determined to a great extent by the fact that women's position on the labour market is weaker than that of men. (This includes lower earning opportunities than men have; a lower rate of participation in the most dynamic sectors of the economy, employment segregation, and family responsibilities - childcare, care for elderly and ill family members, which force women to leave the workforce.) The other factor influencing status is that women retire earlier and live longer, which means that they enjoy a longer period of time in retirement. (Until 1998 the retirement age for women was five years lower than for men. In 2003 men spent an average of 16-17 years in retirement while the average for women was 22-23 years).[14]

The worse than average position of women in the employment patterns triggers lower incomes for women than for men, and the resulting lower pension (the gap between men and women has been a stable roughly 19-20 percent. In comparable occupations it has been less than this, i.e. 14-15 percent).[15]

The differences in pension levels between men and women are about 27-28 percent, calculating with the average of the main benefit. The reason, in addition to the foregoing, is that women generally have a shorter period of employment (Appendix 2, Table 2.9.). The 30 percent widow's pension which can be granted in addition to pensions earned in one's own right reduces that difference significantly, cutting the difference between the two genders to 15 percent. These widows' pensions come to nearly one-third of the average pension and 87 percent of women receive this benefit, which is significant help in providing a livelihood for single persons. The ratios of median pensions to earnings by gender indicate that on the whole, the pension system is more preferential to women than to men.

Gender differences in the pension law

Positive discrimination to the benefit of women is gradually being eliminated in determining the retirement age and by 2009 the retirement age of 62 years will be valid for both genders. The current difference is two years (in 2005 the retirement age for women is 60 years, in 2007 it will be 61 years, and in 2009 applicable retirement age will reach 62 years which is regulated according to year of birth).

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[14] Estimates using life expectancy figures at age 60 years in 2003: for men it was 15.8 years while for women it was 20.6 years; adjusted by the age-centre of retirement (57-58 years for women and 60-61 years for men).

[15] The male-female earnings gap has been a stable roughly 19-20 percent; Employment and earnings rates 1998-2003 (Labour Database) Hungarian Central Statistical Office, Budapest 2005

In other ways the Hungarian pension system is completely gender neutral, offering equal rights. The actual conditions have evolved gradually (granting men the right to surviving spouse's pensions, to childcare benefits).

Measures in the pension system to promote gender equality

The current pension system maintains redistribution mechanisms that significantly reduce the effects of factors detrimental to women. Treatment is equal to both genders when it comes to accessing **various childcare benefits**, for fathers have the same rights to access these benefits (child care allowance, child care fee, child raising support) as mothers, and when calculating pensions, the time spent taking advantage of these benefits qualifies as period of employment for both, therefore the benefit recipient is required to pay pension contribution. Benefits related to **care for a family member** may be accessed by either gender, and here too, pension contributions are made. In both of these cases the employer share of the contribution is covered by the central budget or the local government. In the mandatory fully funded insurance scheme, the actual contribution paid will be credited on the individual pension account. In the social insurance scheme, however, the low amount benefit does not decrease the pension fund because the period is not calculated as creditable period if this is more advantageous for the claimant.

In the mandatory fully funded insurance scheme, the mortality tables used must be the same for both men and women. In other words, a lower annuity may not be set for women because of a longer life expectancy.

The gender impact of pension systems (trends in pension incomes of men and women)

Earlier, when great numbers of women were employed, their eligibility for pensions was quite similar to that of men and a high proportion of women, similarly to men, were entitled to pensions in their own right. At present the employment rate of women is 12.4 percentage points lower than that of men, despite including time spent raising children and caring for family members as period of employment, which projects a deterioration of this situation.

Measures introduced to the social insurance system initially were followed by a closer link between performance and benefits in the 1997 pension reform, with respect to both determining and awarding pensions and to the introduction of the mixed system on long term. The alteration of the pension formula as of 2013 (changing the present degressive pension scale into a linear one) to conform to performance conditions (length of period of employment, differences in income attained) allows extensive scope for differentiation. Starting in the 1990s, female employment dropped to a significantly lower level than had been seen previously, and if this proves to be permanent, the new system, instead of equalising differences, will more strongly reflect earnings differences. We may find ourselves looking at a situation in which pensions for broad sectors of women will be lower than what they would receive under the current conditions, even though many measures in the pension reform reduced the female disadvantage (by fair recognition to time spent raising children). For this reason, the differences between male and female pensions may increase on long term. Only the social insurance system will be able to compensate women for the disadvantages of remaining off the labour market to care for children and ill family members, and it too, will do so on the basis of solidarity.

Critical success factors in handling and managing this process are increasing female employment rate, promoting the reintegration of women caring for children to the labour market and possible combination of job and child care activities.

3.3.3. Other reform issues

The goal is to strengthen incentives to participate in the various pension schemes

The redistributive role of the social insurance system is gradually declining under the new law adopted in 1997:

- a linear gauge adjusted to gross earnings as the basis for contribution payments will be introduced in 2013, degressive calculation of income will be terminated, and the minimum pension will be eliminated, all of which will strengthen the relationship between contributions and benefits. A uniform retirement age of 62 years will go into full effect in 2009.
- Conditions for claiming pension will become tighter. The earliest retirement age will be 59 years, assuming the claimant has at least 37 years of employment period. Relying on the experience of the transitional years, we need to investigate how to offer incentives to encourage contributing to the social insurance system after 2013. This means a need to raise people's awareness and expand their knowledge about the expected level of their future benefits. It is important to let public opinion know about the ways demographic changes will affect the pension system (change in outlook, reinforcement of the prudential concern).

The experience of running the fully funded insurance system for the past seven years tells us that in several areas current rules need to be pushed forward. The goals of this are to:

- improve the transparency of operations,
- cut costs,
- further develop rules applying to annuity provision.

(The measures planned are in Point 3.2.4.)

3.3.4. Transparency, adaptability, and the politics of pension reforms **(objective 11)**

The **goal** is for citizens to trust the pension system, to realistically gauge what they can receive from the statutory schemes and what they have to do for themselves to assure satisfactory living standards in their old age.

Monitoring of pension systems

Pursuant to Act XXXVIII of 1992 on Public Finances, when submitting the annual budget draft to Parliament, a 50-year **projection** of Pension Insurance Fund revenue and expenditure also has to be submitted by way of information. This requirement was introduced in 1998 and after seven years of experience the circle of data has been increased and comparison with the annual budget has improved significantly. The projection includes the effects of legislation adopted in the meantime. The most recent prognosis, made in 2004, includes data computed on the basis of macroeconomic flows and demographic changes

- for average gross and net benefits, by specific type of benefit,
- for the evolvement of the number of benefit recipients,
- for the number of new benefit recipients each year by type of benefit,
- and for the annual Pension Insurance Fund budget.

(Appendix 2., Table 2.10 includes these data)

The Central Administration of National Pension Insurance issues two publications a year with **factual data**, which it distributes extensively (to interest advocacy groups, forums, and seminar participants, etc.). One is the Central Administration's Yearbook which contains actual data on demographic trends, changes in the numbers of persons entitled to benefits, Fund management, specifics of pension and pension type benefit recipients, data on new retirees, determination of pension claims, and the specifics of legal remedies and matters falling under discretionary authority for given years (and sometimes also for the preceding year). The main indices show the rates of insured persons and benefit recipients within the overall population, trends in per capita benefits, the way they compare to net average earnings, pension expenditure as a percentage of GDP, changes in the real value of pensions, and changes in the relative position of pensions compared to net earnings.

The other publication summarises data on the people receiving pensions or pension-type benefits as of January 1 of the given year in a breakdown by type of benefit, year of birth, amount of pension, length of period of employment and year of retirement.

The Hungarian Financial Supervisory Authority (HFSA) prepares regular reports which analyse the main indices of the pension funds, based on the quarterly and annual reports they submit as mandated by law.

The status of pensioners and the pension level is put on Parliament's agenda several times a year. These sessions of Parliament are broadcast by radio and television, and minutes are accessible through the Internet, so public opinion is aware of the topical issues.

Mechanisms for achieving political consensus

The Government will debate the important changes in the pension system with its social partners, and when changes are particularly sensitive, it will attempt to coordinate them with its social partners during the preparatory phase. These issues included, for example, the review of the retirement plan basing eligibility for pension benefits on reaching a certain age, the evolvement of a medical expertise method for invalidity, and determining the financing of advantages.

The government consults with the Council for Elderly Affairs on all changes affecting the pension system. The Council for Elderly Affairs is made up of delegates from retiree interest advocacy groups and professionals who are concerned with elderly issues. It is a government advisory and consultative body chaired by the prime minister.

Providing information to benefit recipients

Despite the campaigns conducted through the 1990s, in this area are some backlogs. As far as pension reform issues are concerned, benefit recipients have access to the background of the regulations. Expected overall conditions have been made public in them (the way the increase in the retirement age is being phased in, the change in the manner of calculating pensions starting in 2013), and the Central Administration of the National Pension provides information via its customer service centres in its county offices.

Beneficiaries can request that their period of insurance within the social insurance system be determined at any time within the 10 years prior to their retirement, but no calculations are made on the expected amount of the pension. Due to the lack of the database on individual entitlement, no information on entitlement acquired is provided. To increase trust in the system, and to prepare the individual, there is an urgent need to evolve a database on individual entitlements and at least provide regular information on entitlements and their expected consequences from a certain age onward. This would help in legalising the black and grey economies and encourage people to make individual savings for their old age.

In the mandatory fully funded insurance scheme and voluntary pension fund scheme a fund member receives annual information on payments credited on his or her individual account and on the expected yield. The Hungarian Financial Supervisory Authority maintains a pension calculation model on its website that it regularly updates. Interested parties can plug in their ages, supposed earnings career, expected period of employment, and calculate the amount of benefits they can expect to receive in the mixed system. Other measures are required to increase social acceptance, which include the followings:

- increasing mandatory information to fund members on performance, costs, and the conditions for receiving benefits, as well as the amount of benefits they can expect;
- boosting government communication means on entitlements and obligations that go with membership;
- improving consumer protection activity, the information fund members have available and expanding their representational opportunities.

On the whole, it is fair to conclude that the persons affected are not fully aware of the amount of pensions they can expect to receive, and they are not given satisfactory information on this from the social insurance system, so insured persons below the age limit cannot calculate how much supplementary savings it would be wise for them to undertake. There is lack of information technology and technical conditions to allow for planning one’s individual pension properly.

4. Conclusions

4.1. Adequacy of pensions

The situation in Hungary regarding the three pension adequacy goals may be summarised in the following way:

There is an extensive redistribution mechanism operating within the current system although it has been narrowed down compared to prior decades. In it is a significant amount of income redistribution for strata that are exposed to poverty risk and disadvantaged situations. The system played an important role in preventing the social exclusion of the elderly or the marginalization of some increasingly vulnerable groups of elderly people.

The pension system - regarding the framework of Hungary's economic potential and general living standards - is intended to offer old people a guaranteed minimum income and a decisive portion of an adequate living standard. Within the framework of the social protection system, by implementing differentiated support and targeted services to the elderly, offering need-based subsistence and supplementary assistance, it is managed to prevent old-age poverty from becoming generally profound. The economic decay following the regime change triggered a significant decline in living standards. Within this, however, the risk of poverty among the elderly population, calculated in per capita net income, was 2 percentage points lower than the risk for the under-60 population (the elderly were not at increased risk when calculated on the basis of incomes per unit of consumption, either.) There are, of course, significant differences behind an average overall picture. It is quite understandable that the pensioners themselves are not satisfied with their current living standards,[16] since they attained their relatively better position against a significant drop in living standards sustained by the active population. The purchasing power of current benefits for about 30 percent of retirees is still 3-10 percent lower than it was at the time they retired.

Living conditions for the elderly on average cannot be considered unfavourable when compared to younger people, particularly to families with children, but life is relatively more expensive for older persons because of the smaller household size. The pension offers a modest but certain financial background; therefore retirees seem to have a more stable financial situation than that of the economically active, who are vulnerable to changes in the labour market. This security is increased in that the purchasing power of pensions has been rising since 1997, and gradual introduction of a 13th month of pension, starting in 2003, is also intended to increase purchasing power. Surviving spouses who are entitled to pensions in their own right are also entitled to 30 percent of their deceased spouse's pension, which is significant assistance towards the maintenance of relatively more expensive single-person households.

Prior to the 1990s, the basic problem of the pension system was that pensions could be attained after meeting entitlement criteria that were comparatively easy to fulfil, but that system did not have financial backing. The resources available to finance the system were far below the

[16] According to surveys conducted and regularly repeated by the Hungarian Central Statistical Office, dissatisfaction among retirees is significantly higher in level than among the economically active.

obligations the system undertook, and in addition to its sharply redistributive character, it contained many obsolete and socially unfair elements. It became clear that the system could not be maintained given those conditions. Therefore, as of the early 1990s, access to the system was gradually made more stringent, to be able to maintain the long-term viability of financing the system. The entire spectrum of the pension policy tools introduced to make the system sustainable, including the measures taken in the 1990s and the structural reform introduced in 1997, is aimed at narrowing the future financing gap, by closing the relationship between the contributions paid and the benefits received.

In the future, the ageing process in Hungary will create a major challenge to maintain living standards for the elderly that are in step with economic development, and minimum subsistence guarantees. Preparation to meet these challenges was begun in the 1990s. On long term, the structural pension reform introduced in 1997 - by boosting the ability and willingness of the economically active to assume a prudential concern and approach towards their old age - will see an increase in diversified, multi-channel retirement savings configurations that contribute to income security in old age. They, in turn, will gradually reduce the load on the social insurance system.

As soon as the pension reform becomes full-fledged it will emphasise the principle of benefits that are proportionate with contributions within the social insurance system, too, cutting back the elements of social solidarity. In the future, it will be possible to more efficiently provide the minimum subsistence guarantees through social transfers outside the pension system. However, it will be necessary to heighten the system of means-tested social supports to the elderly. In addition, arrangements that can respond to the needs of older people and services adjusted to individual life situations will help older people with their lives.

There is a serious risk that old-age poverty will be reproduced because currently the number and rate of persons paying pension contributions on minimum wages is very high, and there is also a significant number of people who do not pay contributions because they do not have the incomes. There are also quite a number of people who deliberately avoid making contributions. A rise in the employment rate can be induced by active incentive and support programmes to counterbalance the labour market influence that drives people into inactiveness, and the efficiency of labour inspections also has to be increased. The widespread nature of the black and grey economies are a serious hazard to the future pension level and carry the risk of increasing poverty in old age.

4.2. The financial sustainability of pension systems is impacted upon unfavourably by a number of demographic flows.

At present, contribution payments collected cover barely over three-quarters of pension expenditures, partly because employer contributions have been reduced so that they can retain their competitiveness, and partly because the mandatory fully funded insurance system is still operating at a loss.

However, on long term, the unfavourable demographic effects will be tangibly mitigated as the 1997 pension reform kicks in and by measures taken in relation to it. On short and medium term it is likely that the deficit at the end of the period will not exceed the value financed by the 2004 central budget. This is because the balance is expected to improve as a result of an increase in the retirement age and of the change in indexation.

The expanding proportion of benefits offered by the fully funded insurance scheme should gradually, starting with 2030, begin to play a significant role in alleviating the financial risk triggered by demographic flows.

Further measures that are necessary to halt the deterioration in financial balance include:

- increasing the employment rate and improving opportunities of older people to access the labour market,
- reducing evasion of contribution payments,
- offering incentives to keep people on the job rather then retiring.

4.3. Modernisation of pension systems, improving its adaptability and transparency are topical issues that are continuously on the agenda. Numerous rules of detail have been adjusted since the structural reform was introduced, and rules for calculating pension eligibility in cases of atypical employment have been updated.

Certain rules on calculating pensions are currently being amended to bring them into conformity with new employer-support arrangements before introducing new forms of atypical employment. The goal is to ensure that the people involved are not put at a disadvantage by the pension rules.

The rules introduced by the pension reform do not present any obstacle to geographical (internal or external) labour mobility, and mobility of labour across legal employment categories.

The Hungarian pension system offers complete gender equality. Various measures of recent years (uniform retirement age, surviving spouse's entitlements, male eligibility for childcare benefits) have altered positive discrimination towards women into an equal system. Childbirth, childcare, domestic care of another close relative who is ill are compensated with low benefits but thanks to special rules, this does not reduce the pensions they receive through the social insurance system. In the fully funded insurance scheme, however, it is not possible to make corrections for career interruptions because of the nature of the financing. However, an insurance-based pension scheme is unable to correct the pension consequences of lower earnings stemming from the less time women spend on the labour market so it would be expedient to handle this by reducing the underlying causes.

At present official information on pension entitlement may be obtained during the ten years preceding retirement age. It would be wise to speed up information technology developments to allow people to receive this information at an earlier date, when still able to deliberately design their savings for their old age in the supplementary systems.

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In light of the fundamental social and economic transformation brought on by the change in Hungary's political system, it is fair to conclude that

- the pension system successfully handled its basic function, for in a period when GDP and real income declined significantly, it prevented older people from mass poverty, while the build-up of a social support and service system reduced the social exclusion of the elderly;
- problems related to the sustainability of the pension system increased in parallel, since the pension system was used to resolve a significant portion of labour market tension;
- as the structural pension reform was being prepared, the latent financing deficits accumulated by the system and the effects it was likely to have on future elderly people came to the surface. Starting up the reform was an important measure towards long-term sustainability. However, until the new fully funded insurance system matures, managing the financial gaps under changing conditions will present new challenges and require additional correction.

The most acute risk to pension adequacy and its financial sustainability is the employment trend, and the ability to reduce and control the illegal economy. The government's recently announced "100 Step" programme has emphasised the idea of offering incentives to employ non-marketable employees in the form of employer supports. Various arrangements to support the employment of older persons, first job seekers, and persons returning to the workforce after caring for children are currently on the designing board (the Labour Market Fund is readying itself to cover a portion of employers' social insurance costs for these workers.) Many proposals on how to reduce contribution payment avoidance and legalise the black and grey economies are currently being studied and elaborated for introduction.

The main factor being considered in designing changes to the unemployment benefit system, the social support system, and the family assistance system, all of which are on the agenda, is how to build in incentives to work. A reform to achieve a proportionate and fair sharing in the public burden is also planned.

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Background statistics for country summaries

	MS			EU-25		
Adequacy						
Current situation (XXXX ECHP/EU-SILC data)						
	Total	Male	Female	Total	Male	Female
At-risk-of-poverty rate[1]						
0-64	10	10	10	….	….	….
65+	8	5	10	….	….	….
75+	10	6	12	….	….	….
Income inequality [1]						
0-64	3.8	3.9	3.7			
65+	2.8	2.7	2.8			
Income of people aged 65+ as a ratio of income of people aged 0-64[1]	0.74	0.69	0.76	….	….	….
Median pensions relative to median earnings[2]	*74*	*69*	*81*			
Long-term projections						
Pension replacement rates [3]	2005	2030	2050			
Total net replacement rate	101.7	97.1	100.4			
Total gross replacement rate	65.6	73.2	79.0			
Gross replacement rate 1st pillar	65.6	59.1	58.5			
Gross replacement rate 2nd pillar II.	0.0	14.1	20.5			
Financial sustainability						
Current situation						
ESSPROS pension expenditure[4] , % of GDP	***1995***	2000	***2002***	***1995***	2000	***2002***
	HCSO	8.7	9.1	….	12.6	….
Employment (2003) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(30-54)***	71.7	73.6	73.7	….	….	….
Employment rate (55-64)	17.1	21.9	25.6	….	….	….
Effective labour market exit aget[6]	….	…..	59.2	….	….	60.4
Public finances (2003) [7]	PM					
Public debt, % of GDP	59.1			63.3		
Budget balance, % of GDP	-6.2			-2.8		

Long-term projections (National projections, 2004)	MS Level			Increase 200X-50	EU-25 Level			Increase 2200X-50
	2003	2030	2050		2003	2030	2050	
Old-age dependency ratio [8]	16.5	27.8	41.7	+25.2	33.6	….	….	….
Public pensions expenditure, % of GDP [9]	9.3	8.9	8.8	-0.5	12.6 (2002)	….	….	….
Factors determining the evolution of public pensions expenditure (2000-2050) [9]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	+3.9							
Employment	-1.2							
Eligibility	-0.9							
Level of benefits	-2.2							
Total (including residual)	-0.5							

Notes:

1. Source: ECHP/EU-SILC, Eurostat, version XXXX. Based on equivalised incomes. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20.
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 including / excluding social benefits other than pensions. See methodological note.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years. See methodol. note.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes; see methodol. note.
5. Source: European Labour Force Survey, XXXX.
6. Calculation method still under discussion.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT, demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Ministry of Finance. Based on appendix to Republic of Hungary's Budget Bill for 2005, October 2004 (includes pre-tax social insurance pension benefits)