Recent changes in the Hungarian pension system

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SUMMARY: *After the pension reform in 1997, the participation in the private pension scheme was mandatory so the private pension scheme had substitute role in a defined measure. However, after the pension reform in 2010–2011 its function has changed. In May 2010, the conservative party had a landslide victory and by 2011 closed the mandatory second old-age pension pillar and used up the released capital to reduce the government deficit and finance public expenditures. These decisions were highly controversial aroused and raise a number of problems. The authors also discuss the issues that go to the national courts and international.*
KEY WORDS: *Hungary, reform in the pension scheme, second old-age pension pillar*

Introduction

The late 1990s and early 2000s saw a wave of pension reforms in Central and Eastern Europe. Nearly all of these reforms saw systemic change to retirement-income provision: the introduction of individual, mandatory, defined-contribution (hereinafter: DC) pensions[1] as a substitute for part of public pension provision.[2,3]

According to the pension insurance provisions, part of the contributions to the PAYG public pension systems were transferred to the funded tier, creating a short term fiscal cost but improving the long-term sustainability of the pension system. In Hungary, all existing workers (insured persons) could choose, but new entrants (career starters, who entered the labour market first time and engaged in any gainful insured activity) had to take the second option of mixed public/private provision.[4] The close link between individual earnings (and so pension insurance contribution) and their benefits was an important aim of many the reform.[5]

During the recent economic crisis, some of these reforms were partially or fully reversed. In Hungary, the reversal has been complete. Even the accumulated assets in the mandatory pension funds were reverted to the state. The analysis of pension entitlements shows that the main cost of these reversals might be borne by individuals in the form of lower benefits in retirement.[6]

In practice, Hungary has entirely reversed the systemic element of the pension reform not only by diverting future contributions back to the state budget, but also by nationalising the

[1] The main feature of the Hungarian 2nd pillar system was: a mandatory, defined-contribution pension scheme. Under these plans, contributions are invested in an individual account and, typically, the accumulation of contributions and investment returns will then be used to provide a regular pension payment in retirement, generally through the purchase of an annuity. In the commonly used jargon, these are described as second-pillar schemes.

[2] The public, mandatory social insurance pension system remained earnings-related, defined-benefit type.

[3] A notable exception to this trend was Slovenia.

[4] See Palacios and Whitehouse (1998); Disney, Palacios and Whitehouse (1999) and Mattil and Whitehouse (2005) for a more detailed analysis and a discussion of the implications for pension policy.

[5] E. Whitehouse, *Reversals of systemic pension reforms in Central and Eastern Europe: Implications*, OECD Social Policy Division, http://www.ebrd.com/downloads/research/news/Whitehouse_Paper.pdf (retrieved 05.05.2014).

[6] *OECD Pensions Outlook 2012*, OECD, 2012.

assets in pension funds.[7] Therefore, in Hungary, the reversal of the systemic reform was complete and permanent: all contributions were reverted to the public scheme from 2011, although a temporary suspension had already been implemented in November 2010.[8] The change is also, in effect, retrospective: the assets in private pensions were appropriated by the government.[9]

Besides the nationalisation of the 2nd pillar old-age pension scheme, some other significant issues of pension-reform took place between September 2007 and February 2012. According to the primary objectives they were the following: a) tighter conditions for early retirement (finally the early retirement was almost completely abolished[10] in Hungary), b) diversion of contributions from mandatory DC plans to public scheme from November 2010 to December 2011, c) closure of mandatory DC schemes in December 2011, transfer of assets (EURO 10.94 billion) to government; (NB.: 100 000 of circa 3 million workers with DC accounts chose to retain DC schemes),[11] d) eliminating the ludicrous 13th month public pensions, e) replacing the combined price-wage indexation of ongoing pensions by pure price indexation (i.e., the rise in pensions is now to be linked purely to prices, which rise more slowly than wages in the long run) and f) embarking on incrementally raising the statutory retirement age from 62 to 65 years between 2012 and 2022.

In sum, the nationalisation of the 2nd pillar system was not the only reform in the examined period, but definitely it was the most significant one, which has fundamentally changed the structure of the Hungarian pension system.

The development of the Hungarian pension system between 1997–2010

For better understanding the old-age pension reform, we are going to introduce briefly the most significant changes which took place since 1997, when the mandatory private pension-pillar was, first in Europe, introduced in Hungary.

Introduction to the mandatory private pension-pillar in 1997–1998

Hungary was the very first country of the Central-Eastern European Countries which adopted the 2nd pillar mandatory, private pension in the late 1990s. After the political transition (1989), the Hungarian pension system problems could be divided into four main reasons: a) economic changes; b) demographic reasons; c) incorrect answers given to the above-mentioned first two points in the public pension system; d) foreign policy reasons.

In the examined period the unemployment rate increased heavily and the black and gray

7 *OECD Pensions Outlook 2012*, OECD, 2012.

8 In practice, individuals could keep their private-pension accounts but at the high cost of forfeiting all public-pension rights. This would leave them worse off relative to the public-pension promise unless private pensions deliver spectacular investment returns. A little over 100 000 people out of approximately 3 million with individual accounts chose this option.

9 *OECD Pensions Outlook 2012*, OECD, 2012.

10 The only permanently existing, systematic exception has been the award of old-age pension regardless of any age criteria for women with an eligibility period of at least 40 years, which was introduced in 2011. Eligibility period refers to a narrower category than the generally applied term of service time in the pension insurance system, as only the enabling period of performing gainful activity and the disbursement period of child raising benefits are accepted under this term. As a further criterion, the exact time of enabling period of performing gainful activity within the at least 40 years of eligibility period may not be less than 32 years. The new retirement alternative is a reward for women who had worked all their active lives and had mostly raised children as well. This provision is against Paragraph (3) of Article XV of the Fundamental Law, which states that „women and men shall have equal rights". It seems that the special old-age pension for women with 40 years of eligibility period is discriminatory, but Paragraph (5) of the same Article – which was inserted into the Fundamental Law as an amendment in 2013 [The amendment was introduced by Article 21(1)f) of the Fourth Amendment to the Fundamental Law (March 25, 2013)] – underlines that by means of separate measures, Hungary shall protect families, children, women, the elderly and persons living with disabilities. This can be regarded as an affirmative action to protect working women.

11 *OECD Pensions Outlook 2012*, OECD, 2012.

economy expanded.[12] The financing of the pension system was one of the most urgent issues to solve. The increase in the dependency ratio made it very clear that pension obligations would not be able to be maintained merely by high pension contributions and without any changes. The pension scheme rules were not followed by the changed economy and the social environment. Until 1997 the pension system encouraged early retirement and did not have any limitation on work while being retired. As a result, the financial balance of the pension system was overturned and the contribution rates were extremely high.

In 1997, following the new pension orthodoxy of the World Bank[13] and because of the above-mentioned reasons, Hungary chose partial privatization pension scheme. The "special legislative package", which was adopted in 1997, was both a parametric and paradigmatic reform. The first parametric component was implemented in the first pillar by raising the legal retirement age uniformly to age 62,[14] which meant seven years increase for women and two years increase for men. The second parametric component was the introduction of the Swiss indexation.[15] The paradigmatic component was the introduction of the second pillar which was based on the fully funded principle of capitalization.

The pension system between 1998–2011 (in particular private pension pillar)

The legal base of the mandatory private pension funds (Act LXXXII of 1997 on Private Pensions and Private Pension Funds) was passed by the Hungarian Parliament and entered into force on January 1, 1998.

The mandatory private pension fund was based on the fully funded principle, which meant that each individual pension accumulated funds in the individual account. It included pensions paid out by funds that were capitalized in universal and/or professional pension funds managed by licensed pension insurance companies. Their financing came from the social insurance contributions made by employers and employees. The value of the assets in the individual accounts was formed by the paid contributions and the return of their investment. Pension funds were officially the form of mutual savings associations whose members were co-owners of the fund.[16] They were administered by the board of directors and monitored by the board of supervisors. Pension funds were supervised by the State Financial Supervisory Authority, which released fund licences.[17]

As a result of the pension reform, the old-age pension scheme became a multi-pillar system. In that time the pillars were the following: a) first pillar: statutory social insurance pension (PAYG), b) second pillar: mandatory private pension (funded, DC system) and c) third pillar: voluntary private pension.

The modified old-age pension system began operating in January 1998, and became mandatory for all new career starters entering the labour market after July of that year. Those who opted for the mixed system would receive a 75 percent benefit provided through the first pillar (PAYG statutory pension insurance). In that time more than half of the insured persons were covered by the second pillar.

According to Article 27 of Act LXXXII of 1997, four types of annuity were provided:

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[12] J. Barta, *A magyar nyugdíjrendszer reformja, különös tekintettel a rendszer második pillérét képező magánnyugdíjpénztárakra*, PhD. thesis, 2000, http://kvt99.lib.uni-miskolc.hu:8080/servlet/eleMEK.server.fs.DocReader?id=160&file=de_2267.pdf (retrieved 15.01.2014).

[13] The World Bank defined the new pension orthodoxy in *the Averting the old age crisis: policies to protect the old and promote* growth World Bank, Washington D.C., 1994.

[14] Previously the statutory retirement age for man was 60 and for women 55.

[15] Swiss indexation is a method with which pension benefits are adjusted taking into account changes in both wages and prices.

[16] J. Hajdú, *The Hungarian old-age pension system in the early 21st century,* In: *Reflections on 20 years of social reform in Central and Eastern Europe*, Edited by: Kristina Koldinská, Martin Stefko, Auditorium, Prague 2010, pp. 186–187 and Peer review on public information on pension systems, ec.europa.eu/social/BlobServlet?docId=8382&langId=en (retrieved 08.05.2014).

[17] Article 106 of Act LXXXII of 1997.

a) a pension payment (*life annuity*) disbursed to the fund member in advance in monthly installments until the end of his/her life, b) a life annuity which the fund pays to the fund member or his/her beneficiary (heir) for a specified period of time (period certain) from the beginning of the pension plan benefit, and following expiration of the set period, until the end of the fund member's life (*life annuity with a fixed beginning period*), c) a life annuity which the fund pays to the fund member until his/her death, and afterwards to the fund member's beneficiary for a period of time (period certain) determined in advance in the benefit regulations of the fund (*life annuity with a fixed end period*); d) a *joint survivorship life annuity*: a pension plan benefit paid to the fund member and his/her beneficiary (or beneficiaries) as long as at least one of them is alive.

Literally invalidity and survivors' pension benefits were not provided by the second pillar. The savings on the individual accounts were inheritable in the accumulation period.[18]

Gradually the Hungarian old-age pension system was supplemented[19] with two new forms of voluntary private savings:

1. The *self-invested personal pension* (nyugdíj-előtakarékossági számla) was introduced by Act CLVI of 2005 on Self-Invested Personal Pension (hereinafter: SIPP).[20] Under the SIPP, individuals have been allowed to open SIPP accounts since January 1, 2006. The advantage of such an account is that the owner has the ability to choose the securities in which he/she wants to invest his/her payments. There are limitations in place, though: only investment instruments or treasury notes issued and securities listed in Member States of the European Economic Area may be purchased from SIPP funds. Products based on forward deals and options are not permitted. One of the objectives of the scheme is to encourage investment in the stock market.[21] In typical case the figure of the investment was increased by the self-investment support granted by the state to the owner of the account.[22]

2. The occupational pension scheme was introduced by Act CXVII of 2007 on Occupational Pension and the Related Institutions. In Hungary the occupational pensions were added to the already-developed pension system as a new form of pension savings. This form of supplementary pension savings was based and developed with the employer's obligation in mind. An occupational pension institution could be founded by a) employer, b) bank, c) insurance joint-stock company, d) investment company or e) occupational pension institution.[23] According to the Act, 'member' means a natural person, who obtains eligibility or is expected to acquire eligibility due to conditional eligibility for occupational pension plan benefits laid down in the statutes, joining agreement between the employer and the institution for occupational retirement provision, employment contract, and collective agreement based on his/her employment or employment described by the legislation of other EEA states. Any employer (hereinafter: joining employer) may join the institution for occupational retirement provision in a way laid down in the statutes. The joining employer must enter into an agreement with the institution for occupational retirement provision, in which it undertakes to pay contribution for its employees.[24]

The key problems of the Hungarian pension system

Besides certain positive elements, the implementation of the multi-pillar pension sys-

[18] J. Hajdú, A. Kun, *The Hungarian pension system in the face of demographic challenges*, in Opuscula Szegediensia 2. Edited by: Lőrincsikné Lajkó Dóra, Pólay Elemér Alapítvány, Szeged, 2008, p. 194 and Act XXII of 1997. 27. §

[19] They still exist, but their popularity among citizens is very limited.

[20] Nemzeti Erőforrás Minisztérium: *Tájékoztató a nyugdíjrendszerről*, www.nefmi.gov.hu/download.php?docID=2593 (retrieved 12.05.2014).

[21] https://www.pwc.com/en_AT/at/newsletter/cee-spotlight/ungarn/pwc_hu_tla_287_12_07_en.pdf (retrieved 12.05.2014).

[22] É. Berde, *Flexicurity Pathways Hungary*, http://unipub.lib.uni-corvinus.hu/1070/1/FlexiHunReportnew.pdf (retrieved 12.05.2014).

[23] J. Hajdú, Studia Iuridica Caroliensia 6., 2011, pp. 43–45. and Act CXVII of 2007. 7–8. §

[24] https://felugyelet.mnb.hu/data/cms2096314/propectus_egt_occpension.pdf (retrieved 28.05.2014).

tem in 1998 brought about many negative consequences, and some positive impact. First we mention the negative elements:

1. The first key problem was that due to the modifications on the Hungarian pension system, the financing of the state pension pillar has become questionable. In the 2011 budget revenues (contributions) of the first pillar of only HUF 2100 billion stood against the benefit payment obligations of over HUF 3000 billion. As a result, in 2011 the state pension system incurred a deficit of HUF 900 billion, thus not complying with the legislation on pension expenditures.

2. Another structural problem of the Hungarian pension system was that there were both solidarity and social care type obligations in the state pension pillar. Solidarity items were related to old age pension liabilities and social items to disability allowance and early retirement benefits. Due to this duality of solidarity and social care items within the first pillar the Hungarian pension system was not transparent.

3. The third problem of the Hungarian pension system was that it gave insufficient incentives for voluntary pension savings, resulting in sub-optimal accumulation of long-term savings in the voluntary private pension funds.

4. The last but most pressing problem of the Hungarian pension system was that there was a shortage of one million legally employed workers paying contributions in the short and medium term, and one million children who could make the system sustainable in the long run.[25]

The introduction of a multi-pillar pension system has, no doubt, also brought positive consequences. The most important of them is probably the promotion of citizens' self-provision and its promotion by the state. Furthermore, a positive development has been an increase of the long-term savings rate parallel to the development of domestic capital markets with higher liquidity.[26]

The transformation of the mandatory private pension pillar in 2010–2012

Due to the global economic crisis, the debt-increasing effect of the Maastricht criteria and the performance constraint of the 2nd pillar funded pension schemes in Hungary were questioned.

The introduction of the mandatory private old-age pension fund system resulted in much higher deficit in the Pension Insurance Fund and the central budget than it was previously calculated because the major part of pension contributions appeared as membership fees in the private pension funds. Hungary sought to alter the way their budget deficit and public debt are calculated in the European Commission. The aim of the petition was to be allowed by the European Union to account for the cost of overhauling their pension system. So the amount transferred to the state pension system from the central government budget would not be part of the state deficit, the compensation for the deficit created by contributions to the private pension funds would not increase the overall deficit of the state budget.[27]

If the private pension fund system had stayed permanently under the legislation prior to the 2010 reform, the Pension Fund deficit would have been expected to be resolved only by 2040. In 2009 the deficit was 1.4% of the GDP due to the membership fee paid out. By 2040 this deficit would be expected to reach 40–50% of the GDP assuming under the same legislation. However, it is important to note that after reaching the "turning point", when private pension funds are able to pay benefits on a pay-as-you-earn basis, they help to reduce the expenditure of the state pension

[25] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

[26] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

[27] J. Barta, *The role and function of the pay-as-you-earn pension system in the Hungarian pension system*, European Integration Studies, Volume 9., Number 1, 2011, pp. 10–11.

system and it can be financed in the longer term despite the worsening ratio of worker to retiree.[28]

During the international financial and economic crisis, the Hungarian pension associations suffered terrible losses but these have since been mostly recovered. As a by-product of this temporary crisis, the government opened the door to enable a voluntary return to the mono-pillar system for those who were older than age 52 in 2009.[29]

On July 16, 2010 after many delays, the government passed amendments to the law on the system of pensions. The government stated: "The essence of the amendments to the law on pensions is that the existing system will not change." So, the reforms that had been promised and deemed necessary because of the dreadful state of financing the current system are not going to be implemented. The reason behind allegedly is that the government discovered that with the changes in the law regarding early retirement and eligibility requirements for "disability retirement" (rokkantnyugdíj), the fund is in good shape even with the ever worsening demographic situation.[30]

At the end of November 2010, when the minister of national economy announced the "nationalization" of savings that over three million people had invested in private pension funds, he promised that the savings would simply be transferred to the state-run pension system.[31] Each employee would retain the hitherto saved amount in an individual account. Moreover, in the event of the pensioner's death, that money could be inherited.[32]

Simultaneously, a commissioner in defence of pensions was appointed. She elaborated on the scheme: „Any employee at any time will be able to ascertain the exact amount he/she has in his/her account and will be able to estimate the size of his/her pension at the time of retirement. The Hungarian government reported to be looking at converting the pension system into a notional defined contribution (NDC) plan similar to Sweden's. Personal accounts would be pooled for investment purposes, benefits would accrue according to workers' contribution and the rate of return on the account. Upon retirement each worker's account balance would be automatically converted to an annuity that would tie the benefit to shifts in life expectancy.[33] However, it is important to note that there are no real assets behind the individual accounts. The individual accounts are registered only in entitlement and it is expected to ease the calculation of the retirement benefits.[34]

In February 2011 Prime Minister Viktor Orbán promised that this new system of individual accounts will be ready to be implemented by the end of 2011. All these promises were necessary to entice more and more people to switch their accounts from private funds to the common state-run system. However, these promises were never realised in the legislation and in the practice. From the facts it seems that that the government never had any real intention of introducing a new

[28] K. János, *A tyúk nem tojik aranytojást - gondolatok a magánnyugdíjpénztárakról.* 2009, http://www.mebal.hu/index.php?option=com_content&view=article&id=281:kun-janos-a-tyuk-nem-tojik-aranytojast-gondolatok-a-magan-nyugdijpenztarakrol&catid=59:egyeb-fontos&Itemid=93 (retrieved 10.06.2014).

[29] A. Simonovits, *The mandatory private pension pillar in Hungary: an obituary*, Institute of Economics, 2011. p. 13.

[30] 1281/2010. kormányhatározat (government decision) 1st point.

[31] The original idea of Hungary's Minister of National Economy in November 2010 was the effective dismantling of the country's mandatory private, funded pension system by promising that anybody who fails to opt back into the state system, accumulated assets and all, will lose all rights to a state pension on retirement. Although they will still be obliged to top up their pay-as-you-go state pension contributions, they will get nothing back in return. Explaining the decision, Mr Matolcsy said: "I want to make it clear. [People who do not opt back in] are no longer part of the solidarity-based state pension system… Private pension fund members will have written themselves out of the community, and will be going their own way."

[32] http://www.economist.com/blogs/easternapproaches/2010/11/hungarian_pensions (retrieved 11.06.2014).

[33] http://peoplespension.infoshop.org/blogs-mu/2010/06/21/hungary-template-for-social-securitys-future/

[34] Lados Dóra Rozália, *Mérlegen a magánnyugdíjpénztári rendszer működése Magyarországon*, In: Székely Tünde (szerk.): *XII. Rodosz Konferenciakötet, Társadalomtudományok* 2. kötet, Rodosz-Editura Marineasa, Kolozsvár-Temesvár, 2011, pp. 31–47.

system of individual accounts because the nationalized private pension funds never made it into the system. A part of that enormous amount of money (three trillion forints) was spent on current expenses while another part was lost in the stock market. So there was nothing to add to the individual accounts.[35]

At the end of 2011 there was still no new law. In January 2012 the commissioner in defence of pension admitted that "there is still a debate concerning different concepts but by the middle of the year a decision will be made." Even in April 2012, when the second Kálmán Széll Plan (Kálmán Széll Plan 2.0) was released, the government promised "the introduction of individual accounts in the pension plan."

Kálmán Széll Plan 2.0 was supposed to prove to the European Commission that the government is planning to put its financial house in order. One of the most important and serious issues is the protection of future pension. Therefore, the Kálmán Széll Plan 2.0 states: "The aging of the population is accompanied by increased expenses and if no appropriate measures are taken it influences the growth of the sovereign debt in the long run". It seemed that the government was ready to worry about all this later because the nationalized savings of three million people were gone, and there were no other funds to put into these people's nonexistent accounts.[36]

The objective of the comprehensive pension reform was to return to the two-pillar pension system, based on social solidarity on the one hand and voluntary contributions on the other, which is in place in eighteen EU Member States, from the previous three-pillar system which is hopelessly threatening the budget balance, and is financially unviable in the short, medium or long run. Having accomplished this transformation, the government was committed to maintaining and supporting voluntary private pension funds parallel to the state-run social security pension pillar. [37]

The cornerstones of the Hungarian pension reform

To correct the above-mentioned structural anomalies of the Hungarian pension system, the Hungarian government has decided to conduct a four-step pension reform in order to ensure solid financing of the system in the short and medium term, and create a sound basis for the pension system becoming sustainable by 2050.

The questions concerning the pension reform are the following:

1. In order to establish the funding of the state pension system in the short and medium term, the government intended to close the gap in the pension fund's budget. This was planned to achieve by rechannelling the mandatory private pension fund contributions into the state pension fund (a suspension of contributions for 14 months, Act CI of 2010) as sat in the budgets of 2010 and 2011, as well as by using part of the funds of those opting back to the state run PAYG system. The government planned to use HUF 530 billion of these resources in 2011 and HUF 250 billion in 2012 on correcting the deficit of the state pension system.[38] But critics say that the pensions move simply allows the government to plug a short-term budget shortfall without implementing painful structural reforms and at the cost of the long-term sustainability of the system.[39]

2. According to the government plan, the participation in the second pillar would no longer be mandatory and the government shall offer a free choice between pension systems (Act C of 2010). The members of the

[35] http://hungarianspectrum.wordpress.com/2012/08/01/pension-reform-in-hungary-the-disappearance-of-stolen-goods/ (retrieved 13.06.2014).

[36] http://hungarianspectrum.wordpress.com/2012/08/01/pension-reform-in-hungary-the-disappearance-of-stolen-goods/ (retrieved 13.06.2014).

[37] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/ThereformoftheHungarianpensionsystem.pdf (retrieved 10.06.2014).

[38] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/ThereformoftheHungarianpensionsystem.pdf (retrieved 10.06.2014).

[39] http://www.ft.com/cms/s/0/0e01c370-06de-11e0-8c29-00144feabdc0.html#axzz35b9COao0 (retrieved 10.06.2014).

no-longer-mandatory private pension funds (second pillar) were offered the opportunity to opt back to the state pension system (first pillar), while they would also have the liberty to opt for staying in the voluntary private pension fund system. In case of the latter, upon decision by its members, the second and third pillars can be merged in the long term. [40] Apparently, the government has billed this as the freedom to choose. But, in fact, there was no choice there: this was compulsory nationalisation.[41,42]

3. According to the government's decision, as from January 1, 2013 there must be a balance between contributions and expenditures. To this end, the government replaced contributions paid by employers by a social tax[43] of the same extent. Solidarity and social care liabilities, as it was stipulated by the Hungarian Fundamental Law (Constitution), were separated, and financed by the state pension fund and a new state-run social care fund, respectively. As it was planned, from January 1, 2013, there should be an individual account for the accumulated pension savings for each citizen registered at the state pension system. However, these individual accounts have never been realised.[44]

4. According to the government's decision, the Hungarian pension system is recently based on two pillars: the state pension pillar (PAYG) and the voluntary private (funded) pension pillar. It was emphasized by the government that the sustainability of Hungary's pension system largely depends on two factors: 1. the long-term employment rate and 2. the demographic situation (mortality, life expectancy, birth rate, etc.). There is no pension system which could handle the unfavourable changes of these factors in a sustainable manner or compensate for their damaging impact on the society or financial policies. Accordingly, besides the stimulation of sustainable economic growth, the government has made it a priority of its economic policy to improve employment and stop the demographic decline.[45]

The reformed pension system in Hungary

As a fact, Hungarians hold assets worth about 2,700 billion forints in private pension funds. The original plan of the Hungarian Government was that if a former mandatory private pension fund member voluntarily decides not to opt back to the social security pension system, after December 31, 2011 he/she would be allowed to contribute 100% of the employee's pension contribution to the private pension fund system. In this case, however, he/she will exit the social security pension system and will not accrue further pension rights for future service years. Later this „punishment" was abolished and the remaining fund members can keep their previous right for state pension as well. The key objectives of the proposed measures was to improve the budget balance having been gradually deteriorated year on year since the implementation of the multi-pillar system, to reduce budget financing requirements and to cut explicit public debt relative to GDP in order to minimize the country's exposure to external shocks.[46] These goals must be achieved by maintaining

40 http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

41 NB.: Before their choice was taken away from them, surveys showed that only 30% of fund members were planning to opt back into the state pension.

42 http://www.economist.com/blogs/easternapproaches/2010/11/hungarian_pensions (retrieved 15.06.2014).

43 As of 2012, the Government has combined the various contributions payable by employers (health insurance, unemployment insurance, pension) into a single tax, the social contribution tax. The rate of the new tax is 27%, the same as the aggregate rates of the contributions replaced.

44 http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

45 http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

46 Prime Minister Orbán announced that HUF 1,345 billion of the pension takings will go directly to reducing state debt. Through the move, the country will be able to reduce what it owes to 77% of the GDP from 81% in a single move, something he labelled a "world record".

or possibly improving the viability of the pension system in the medium and long run. The government also intended to find a solution for the active legal workforce considering that their accumulated savings in a private pension fund were insecure and the guarantees offered for limiting risks were insufficient.[47] The costs of the comprehensive pension reform would be covered by the revenues from the merger of the state and the mandatory, fully-funded – quasi state-run – systems, no other budget resource will be made available for this. [48]

The impact of this measure (total reversal) was far-reaching. It effectively ended the mandatory private provision of pensions in Hungary and greatly knocked public confidence. Mandatory private provision was important to investors in Hungary, because it was one of the few tax-efficient means of accumulating wealth that may be passed on through inheritance. As a result, in Hungary, not only is there no second pillar (mandatory) pension system, there is little trust among the average consumer in saving at all. There is certainly no interest from providers to create a financial services market. As a potential solution, the government encourages employers to use the third pillar (occupational pension) but there have been no new market players in since the change.

At the end of March 2014, eight private pension funds were operated with 62,382 fund members. Due to the small number of remaining members and the low-kept operating cost, the long run survival of the mandatory private pension fund is definitely questionable.[49] There is no regulation for the definition and the disbursement of annuity. The lump sum payment is regulated, although it is not considered life annuity and the main aim of the second pillar would be regular payments.

One of the main problems with the elimination of the second pillar is it does nothing to make the system more sustainable. Demographic changes mean the population above 65 – the retirement age recently increased from 62 – has increased significantly and is forecast to grow from more than 16 per cent in 2006 to above 20 per cent by 2020. This is the effect of baby boomers, as much a demographic problem in the east as it is in the west.[50]

As it was mentioned above, the fundamental aim of the Hungarian Government was to create a two-pillar pension system. Having completed the pension reform, the first pillar is managed and monitored by the state and financed from the central budget (literally no classical social insurance pension exists in Hungary). The paramount objective of the reform is to secure the old age pension of the population by securing adequate living standards and optimal financial security compared to the general living standards and the financial capacities of the country.[51]

According to the plan of the Government, the base of calculating a proportionate and fair old age pension benefit would be individual accounts[52] to be set up in the state pillar on which pension contributions of each employee would be kept. In the current state pillar, widows or orphans can be entitled to obtain (inherit) the right to pension benefits. After the reform, an individual account can be inherited too, that is, the pension savings of a deceased will be added to the account of the surviving spouse (or the descendent) to contribute to his/her benefits. However, the would-be inheritance regulation on pension savings must adhere to the principle of a balanced state and pension fund budget.[53]

According to the Government plan, the second main pillar created by the reforms

[47] http://www.bbj.hu/economy/real-yields-of-pension-funds-to-be-received-in-the-mail_59160 (retrieved 19.06.2014).
[48] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 19.06.2014).
[49] Pension funds operating in the second pillar wanted to keep as many clients as possible, but simply could not survive. Even the largest Hungarian bank, OTP, had to dissolve its fund recently.
[50] http://www.europeanpensions.net/ep/attacking-the-second-pillar.php (retrieved 10.06.2014).
[51] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).
[52] NB.: The individual old-age pension account has not been implemented in July 2014.
[53] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

would be a system supported by the state and managed by the private sector alongside the guidelines set by the state to promote the interest of members, which will enable the accumulation of voluntary pension savings. This new private pillar would keep the advantages and eliminate the disadvantages of the previous mandatory private pension pillar. Voluntary pension savings and self-provision can be encouraged only by means of giving the freedom of choice. Thus the second pillar must cease to be mandatory. In the future, the government also intends to stimulate citizens' self-provision and consequently boost the long-term savings rate to a greater extent than before by the help of the tax system and indirect incentives, and at the same time improving domestic financing capabilities of the country.[54]

Furthermore, according to the view of the Hungarian Government, in order to reach the targeted balanced budget required from the social security pension system, pension benefits must be separated from non-pension or welfare benefits which should be accounted as government budget items. As part of the transformation of the Hungarian public finances system, a principle will be laid down in the new law on public finances that pension benefits can only be financed by pension contributions without utilizing other budget resources. The costs of this reform must be financed by the merging of the state and quasi-state pension pillars without additional resources from the government budget.[55]

As an additional concern, even though the government now claims that the pension system has been "saved" and has become sustainable, experts say this assumption is far from true. An OECD directive that is also accepted by the EU declared that citizens of Member States need to receive at least 70% of the respective country's average earnings as their pensions in order to have acceptable sustenance when they retire.[56] It is generally accepted that a solely state-run pension system will not be able to cover the gap.[57]

The decision of the European Court of Human Rights on the Hungarian mandatory private pension case

The background of the case was that in November 2010, the Hungarian government adopted a series of laws providing that all pension contributions paid by employees were to be paid into the State pension fund with the aim of reducing its deficit. A further amendment provided that the contributions to the mandatory private fund would be directed to the State Central Budget.

The applicant[58] chose to remain a private pension fund member, meaning that she would be entitled to receive a full state pension for service after November 1, 2010, and 75% of the regular State pension for contributions prior to that date, with the remaining 25% being disbursed by the private pension fund. She complained[59] that the new legislation amounted to a confiscation of her property, because the new pension fell short of a pension scheme that was directly related to her contributions and investment strategy.[60]

The judges of the ECHR have rejected a complaint alleging that Hungary's new pension system effectively amounted to the state

[54] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 10.06.2014).

[55] http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0-92D7-42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf (retrieved 19.06.2014).

[56] As pension benefits are not subject to taxation in Hungary, this indicator actually compares pension benefits to average net wages. The indicator, used by the EU and hardly interpretable in case of Hungary, comparing average net pension benefits to national gross wages, was 38.9% in Hungary in 2007 for all pensioners which is below the 49.7% average in the EU; and, similarly to the EU average, it will decrease by about 9% points during the period of 2007–2060.

[57] http://www.bbj.hu/economy/real-yields-of-pension-funds-to-be-received-in-the-mail_59160 (retrieved 12.06.2014).

[58] The complaint was made by Ms E.B., a Hungarian and Serbian national who was born in 1983 and currently lives in Budapest.

[59] The complaint concerned legal changes to the Hungarian pension system in 2010.

[60] http://index.hu/gazdasag/2013/01/30/strasbourg_rendben_volt_a_nyugdijallamositas/ (retrieved 18.06.2014).

confiscation of private pension contributions. In its decision[61] the European Court of Human Rights has unanimously declared the application inadmissible.[62]

As for reasoning, the Court re-iterated its previous holding in Maggio and others v. Italy, that one's right to property does not guarantee any right to a particular amount of pension. It further held that despite the obligatory contributions to the state pension fund, the applicant remained free to make contributions to her private one. The Court observed that Ms E.B.'s contributions to the private funds before November 1, 2010 remained intact under the new legislation, and that the ones made afterwards were transformed into an entitlement under the State scheme. Similarly, her service time was recognised in the periods both before and after the change in legislation. Any speculation as to accumulating service years domestically or abroad was, for the Court, immaterial. Quite besides the fact that the situation complained of resulted from Ms E.B.'s own choice, she was in any case entitled to future pension payments through the contributions she had made during the entire period of her employment either to the private pension fund or the State fund. There had therefore been no interference with her property rights, including her legitimate expectation to receive a pension in the future.

Therefore the Court found that the applicant had not been deprived of her previous contributions, and she was entitled to future pension payments through all of the contributions that she had made. Accordingly, the Court ruled that there had been no interference with the applicant's rights to property under Article 1 of Protocol 1, and that the application was inadmissible pursuant to Article 35(4) of the Convention.[63]

According to our opinion, it seems that the ECHR did not discuss the core point of the claim. From the claimant's point of view, the main issue of nationalising the 2nd pillar pension was the future (potential) yield of the already cumulated individual pension account. (It could be a quite reasonable amount if a person joined the 2nd pillar at the very beginning. In such case almost 12 years of savings could be cumulated on his/her account.) The government promised to establish an individual pension account where the private savings should be kept, but it has not been realised yet. That is the reason why we think that the ECHR misinterpreted the complaint.

Conclusion

After the political transition (1989) there were two major pension reforms implemented in Hungary: one in 1997 and in 2010–2011. Both reforms brought and underwent significant changes.

After the pension reform in 1997, the participation in the private pension scheme was mandatory so the private pension scheme had substitute role in a defined measure. However, after the pension reform in 2010–2011 its function has changed. In May 2010, the conservative party had a landslide victory and by 2011 closed the mandatory second old-age pension pillar and used up the released capital to reduce the government deficit and finance public expenditures.[64]

Hungary went a long way towards fully scrapping its second pension pillar. In early October 2010, the government announced a temporary suspension of contributions to the second pillar for 14 months and the possibility for workers to leave the second pillar. Only a month later, the death sentence of the second pillar was passed into law. People had two months until January 2011 to decide whether they wanted to stay in the second pillar, with automatic return to the first pillar being the default option. The disincentives to stay

[61] European Court of Human Rights, Judgment of January 15, 2013 on the case of E.B. (No. 2) v. Hungary (application no. 34929/11).

[62] http://privatbankar.hu/ongondoskodas/nyugdijpenztarak-furcsa-dontest-hozott-az-eu-birosaga-254660 (retrieved 18.06.2014).

[63] http://www.humanrightseurope.org/2013/02/judges-reject-challenge-to-hungarys-pension-revamp/ (retrieved 21.06.2014).

[64] A. Simonovits, *International Economic Crisis and the Hungarian Pension Reform*, Discussion papers MT-DP – 2011/11, Institute of Economics, Hungarian Academy of Sciences, Budapest, 2011, p. 6.

were very strong: for those who decided to stay, the employees' contribution would increase from 8 to 10% of gross salary and they would loose all entitlement from the first pension pillar that would stem from contributions paid starting in 2011. As a result, only 3% of the insured and 10% of the pension funds remained in the second pillar. 97% of second-pillar pension members left the system. The government effectively nationalised the private pension funds' assets. To offer some very low amount of compensation, those who returned to the first pillar received a cash cheque for the real returns on their pension assets for the years of their membership. The final nail in the coffin of the second pillar was the decision in late 2011 to permanently divert pension contributions of the few remaining members to the first pillar.[65]

Therefore the role of the former mandatory private pension funds significantly marginalized, which caused intense debates among the experts.

As it was highlighted in this article, Hungary has been carrying out a comprehensive pension reform in the last couple of years. The country is about to return to the two-pillar pension system, operated by eighteen EU Member States and based on social solidarity, from the three-pillar system destabilizing the budget and unviable in the short, medium and long term. This new phase of the Hungarian pension system's reform is also a reform's reform, which keeps the positive elements from earlier reforms but corrects the shortcomings inflicted on the state pension system by the implementation of the second pillar, i.e. the compulsory private pension fund system.

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[65] B. Égert, *The Impact of Changes in Second Pension Pillars on Public Finances in Central and Eastern Europe*, Economics Department Working Papers No. 942, OECD 2012, p. 11.

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Ostatnie zmiany węgierskiego systemu emerytalnego

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STRESZCZENIE: *Opracowanie przedstawia reformę węgierskiego systemu emerytalnego. Po jej wprowadzeniu w 1997 r. udział w prywatnym systemie emerytalnym był obowiązkowy i miał on odgrywać istotną rolę w tym systemie. Jednak po kolejnej reformie w latach 2010–2011 jego funkcja uległa zmianie. Było to konsekwencją przemian politycznych (zwycięstwo konserwatywnej partii w wyborach w maju 2010 r.), polegających na zmianie charakteru uczestnictwa w drugim filarze i faktycznie do 2011 r. „zamknięciu" obowiązkowego drugiego filara emerytalnego. Nastąpiło także wykorzystanie uwolnionego kapitału w celu zmniejszenia deficytu budżetowego i finansowania wydatków publicznych. Decyzje te były bardzo kontrowersyjne. Budziły i budzą szereg problemów. Autorzy omawiają m.in. sprawy z tego obszaru, które trafiają do sądów, w tym Europejskiego Trybunału Praw Człowieka.*

SŁOWA KLUCZOWE: *Węgry, reforma systemu emerytalnego, drugi filar systemu emerytalnego*