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Hungary social briefing:
The Pension System in Hungary

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The Pension System in Hungary

Better health, longer-living societies are the achievements of modernization and of the technological progress that has taken place over the last five decades, but the success itself created the question of how to sustain the pension systems that were created to deal with the health care and retirement issues of much younger societies. In those societies, the ratio of working to non-working people did not place such a financial burden on the younger classes, while we must admit that older people can generally work longer in many cases because of their better health. The question of how to create a system that is geared to the long term arises, therefore it is more difficult to adapt to a new environment can respond to the challenges ahead.

Reform in the Hungarian pension system since 1990 – an introduction

The history of the Hungarian pension system covers three periods. The first lasted from 1990 to 1997, when reforms aimed at adapting the pension system to the new political system and market economy conditions. During this period, the Hungarian economy was marked by mass unemployment and 1.2 million jobs were lost. The financial basis of the pension system was undermined in this way, as the pension payments of these 1.2 million people were missing from the system. In addition, mass unemployment was partially managed through early retirement and disability pensions. As a result of these policies, pension system expenditures increased significantly and accounted for more than 10 percent of the declining GDP.

The next period was from 1998 to 2010, when private pension funds were created and added to the already existing system. The reform was originally initiated by the State Reform Commission in 1994, but the original proposal was significantly reformulated when the Ministry of Finance implemented the reform in 1997. The introduction of the private pension funds was based on ideas from the IMF and the World Bank. They argued that the participation of foreign banks and insurance companies in countries with capital shortages would have a positive impact on investments, boost the economy and indirectly create jobs. The social liberal government in Hungary opted for the Argentine model, which meant partial privatization of the pension system. Membership in the newly established private pension funds was mandatory for new workers, while those already in the system were free to choose whether they would take up membership. Social contributions were partially diverted to the private pension funds with about 31 percent of all social contributions going to the privatized pension system. This also means that the public pension system dominated the system despite privatization. When the proposal was implemented, the reform was heavily criticized by the opposition, and Fidesz argued that if the new pension system were to be implemented, international capital would gain a foothold in Hungary.

The third period of the Hungarian pension system began in 2011, when private pension funds were nationalized, and the possibility of early retirement and disability pensions was reduced or eliminated. As a result of the reform, the pension system again consists of two parts: the public pension fund and the voluntary private pension funds.

The present state of the Hungarian pension system

The drastic steps leading to a major overhaul and redesign of pension system can be explained by macroeconomic factors. We must not forget that the Hungarian economy had to be bailed out by the IMF and European Commission after the collapse of Lehman Brothers in 2008. The decline in GDP and the subsequent financial crisis led to the collapse of budget revenues, which directly caused a crisis in the pension system. The diversion of private pension funds to public pension funds was initially considered temporary, but after fourteen months, the government allowed people to voluntarily pay back into the public private funds, and about 97 percent of people took advantage of this option. The diverted assets accounted for 10 percent of Hungary's GDP.

Table 1. The Hungarian Pension System after 2011		
Pillar	Responsible authorities	Financing
0. Minimum pension and allowance for elderly people	Pension insurance fund and local authorities	Mandatory social contributions and taxes
1. Mandatory pension	Pension insurance fund	Mandatory employees' and employers' social contributions
2. Voluntary pension	Private insurance funds	Private savings
Source: Szikra (2017): A magyar nyugdíjrendszer 2011 óta		

Basically, there are three main institutions that administer and maintain the Hungarian pension system:

- the Pension Insurance Fund is the fund through which the financial processes of the pension system take place.

- the General Directorate of Pension Insurance acts as the central budgetary authority, which is part of the Ministry Human Capacities.

Pension Insurance Control Commission controls the efficient use of pension funds.

Challenges

The Hungarian society is an aging society as many other European countries are. In 2020, the old-age dependency ratio was 30.3. The indicator shows the ratio of elderly people (over 65 years old) compared to the population between 15 and 64 years old. In 2015, this indicator was 22.7. The difference between the two years shows the need for a reaction and a reform of the pension system. The sustainable change would be to increase the number of newborn children, which is a very clear goal of the Fidesz-KDNP government. Changing demographics are difficult to achieve and even if they are successful, it will take many years before this policy can lead to a significant improvement in the financing of the pension system. The Hungarian ratio is below the EU average and is the second lowest among the Visegrad countries.

The aging process can be easily represented by the aging index, which shows the ratio of elderly people (over 65 years old) compared to the population under 15 years old. This indicator is less useful for the analysis of the pension system, but it shows the aging process of the Hungarian society. The indicator was 139.6 in 2020, while the index was much lower in 2005 (99.9). When it comes to the aging index, it shows significant differences between regions, while the old-age dependency ratio mentioned above does not. In Budapest, the aging index was 156.8, while the same index in Pest County was 103.9.

Table 2. Dependency ratio and aging index in Hungary between 2005 and 2020

	2005	2010	2015	2020
Old-age dependency ratio	22.7	24.2	26.5	30.3
Aging index	99.9	112.6	123.6	136.6

Source: Hungarian Central Statistical Office database

Table 2. Old-age dependency ratio (2019, %)	
EU-27	31.4
Belgium	29.5
Bulgaria	33.2
Czechia	30.4
Denmark	30.6
Germany	33.2
Estonia	31.0
Ireland	21.6
Greece	34.6
Spain	29.5
France	32.5
Croatia	31.6
Italy	35.7
Cyprus	23.8
Latvia	31.7
Lithuania	30.4
Luxembourg	20.7
Hungary	*29.3*
Malta	27.6
Netherlands	29.5
Austria	28.2
Poland	26.4
Portugal	33.9
Romania	28.1
Slovenia	30.5
Slovakia	23.5
Finland	35.1
Sweden	31.9
Source: Eurostat	

As a result of these processes, we can claim that the next reform of the Hungarian pension system seems to be inevitable. After the summary of the prevailing tendencies, the following steps can be done in theory:

- The significant increase of pension contributions. The level of contributions is not low, and we should add that the low taxation of Hungarian companies is one of the main competitive advantages of the Hungarian economy, so this step is highly unlikely. It would stifle Hungarian companies and have a negative impact on foreign investments.

- The retirement age can be increased. Although this step would be highly unpopular amongst Hungarian citizens, we cannot rule out this possibility due to European and global trends.
- A reduction in pension payments would also be negatively received by the public and would have a negative impact on the life quality of pensioners.

Strengthening voluntary savings and supporting demographic trends seem to be the steps preferred by the Hungarian government and these steps fit better into the development strategy of the Hungarian economy, which basically puts a strong emphasis on increasing self-sufficiency in every economic sector. This also explains the strong anti-migration stance of the Hungarian government, which does not want to solve Hungary's demographic problems by increasing the influx of workers into the country, which would alleviate the problems in the short term, but would completely change the demographic trends of the country in the long term.

Summary

As we have seen in the analysis, the Hungarian pension system underwent two significant changes in the last three decades, the 1997 and 2010 reforms, which took the pension system in two different directions. The first was a neoliberal attempt to partially privatize a public task, namely the care of the elderly. As mentioned above, the reform was inspired by the plans and proposals of the IMF and the World Bank. Partial privatization might have served the wealthy and the state of the public budget better, but it would have left the less fortunate strata of Hungarian society in the lurch. It is clear that the return to a fully public pension system solved most of these problems and led the Hungarian government to look for other alternatives.