MINISTRY
FOR NATIONAL ECONOMY

The transformation of the pension system

Focus

In the past few years the Pension Protection Fund required a contribution of 600-700 billion forints from the central budget. What is more, the state pension system would have closed with a deficit of 800 billion forints in 2011 but for the measures of the Orbán government in 2010. The expenditure on pensions is high even in an international comparison and as a consequence of the deteriorating demographic indicators, the problem can become even graver. To rectify the situation, the government focuses on two areas, increasing employment and putting an end to the decrease of population.

Background

The pension system, created by the turn of the 2010's, in its present structure and with the applied constructions and regulations cannot be financed even in the short-term. It can practically be maintained in the medium-term by levying public taxes and from central sources.

According to the practice used so far, the pension fund had to be supplemented by 600-700 billion forints deriving from the taxpayers' contributions or foreign loans as the revenues did not cover expenditures on pensions.

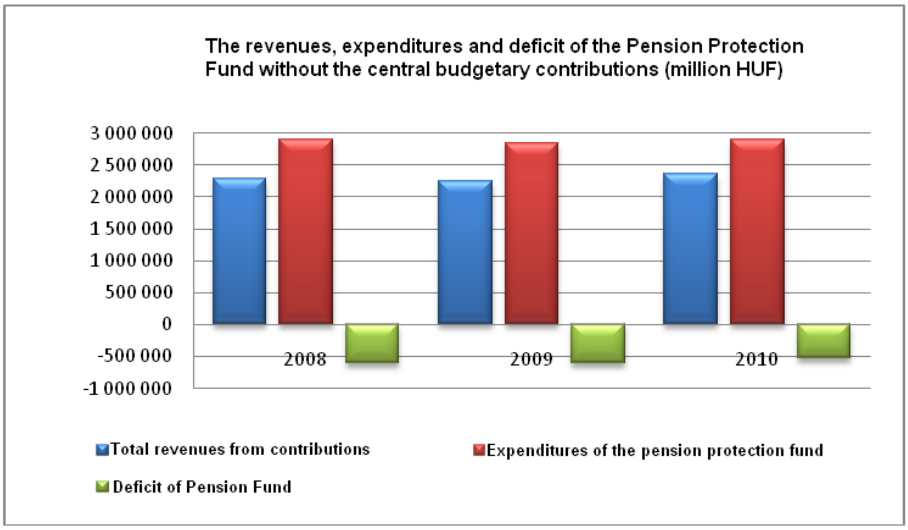

Figure 1 **Source ONYF**

In the budget for 2011 in contrast with a slightly more than 3050 billion forint expenses on pensions , the revenues of the state pension funds would have amounted only to 2260 billion forints but for the provisions of Act CI. /2010 on the modification of payment into private pension funds. In this way, **the state pension fund would have closed with a deficit of 800 billion forints in 2011**, which cannot be sustained with regards to the Act in effect.

In an international comparison **the expenditure on pensions in Hungary as of GDP is high and continuously growing**. We spend more on social expenses such as pensions, social benefits family support and unemployment benefit than the other Visegrád countries. Pensions and family support explain more than half of the difference. Due to the permanent measures affecting pensions and other society-related expenses the difference from the other Visegrád countries that was discernible from 2009-2010 is expected to diminish.

‘Cornerstones’

Demographic situation

There are significant challenges of the pension system such as ageing population, which is not only a typical process of Hungary but also of the majority of the developed countries.

The proportion of those aged above 65 of the total population was continuously growing between 2000 and 2008 in Hungary and the countries of the EU-27. In our country this proportion grew from 15 percent in 2000 to 16.4 percent in 2009 during nine years which, in the meantime, continually exceeded the figures of the Visegrád countries.

Taking the long-term sustainability of the pension system in Hungary into account, the fact that the dependency rate of the ageing population will grow from the annual 24.2 percent in 2010 to 57.6 percent in 2060 in Hungary, is of extreme importance. Similar tendencies are discernible in the other Visegrád countries and the averages of the present member states of the European Union.

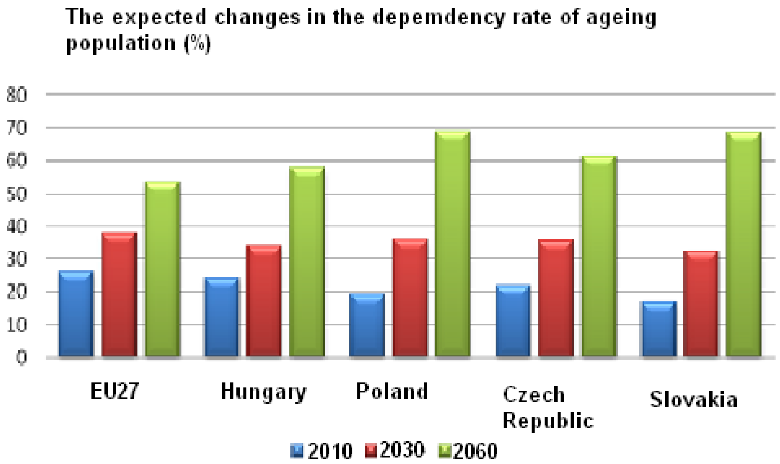

Figure 2 Source: Eurostat

In addition to the changes in the demographic indicators, the sustainability of the national pension system is further aggravated by the fact that due to the excessive presence of the different social elements **a great proportion of the population is provided with pensions even below the statutory retirement age,** which is illustrated by the pyramid below on the basis of the data available in January 2010.

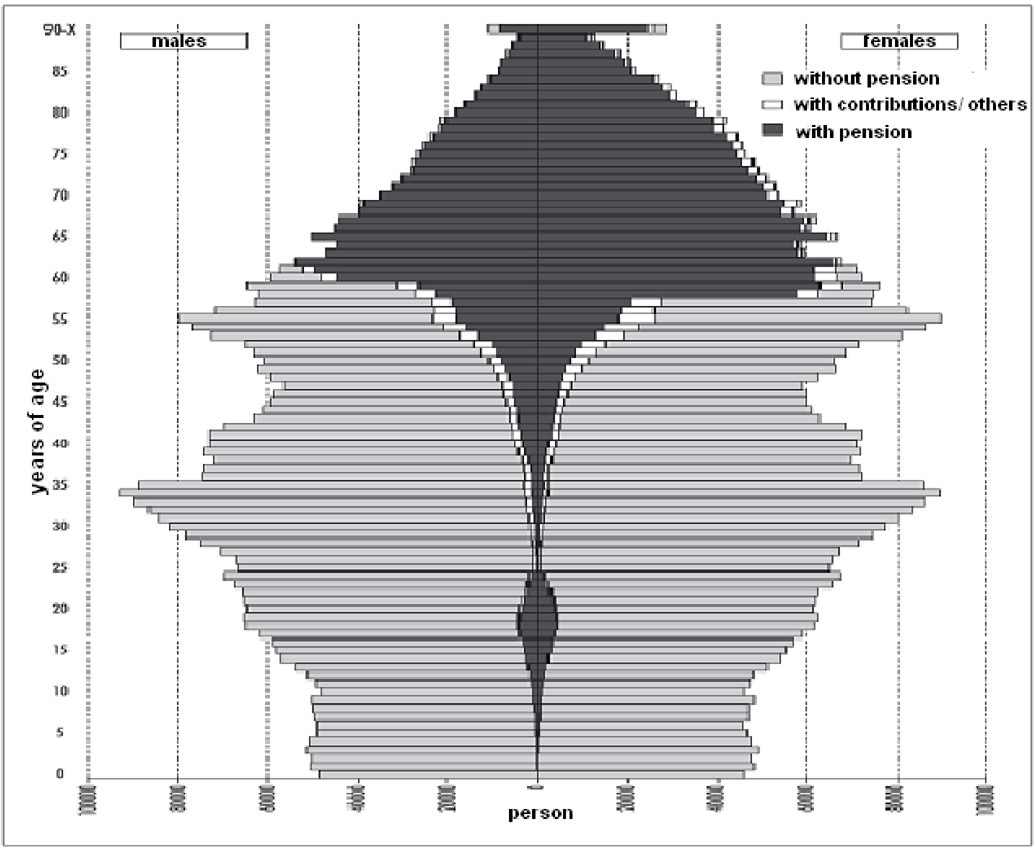

Figure 3

Source: ONYF Statistical Yearbook 2009

Governmental measures taken so far

To ensure short and long-term financing of the state pension system **the deficit of the state pension fund was abolished.** Its expenses will be covered partly by the redirection of the compulsory private pension payments into the state pension funds (Act CI. /2010) in the budget for 2010 and 2011 and partly by making use of the funds of the members transferring from the compulsory private pension system to the state system. Of the latter resource, 434 billion forints were used to balance the deficit of the state pension system in 2011.

The compulsory nature of the second pillar was also abolished together with the compulsory membership in private pension funds, and the freedom of selecting a pension system was achieved (Act C./2010). **This step was not only important due to the transformation of the pension system. As a result, the pension reform will reduce debt that can be regarded as the biggest problem of the country both in the short and long-term. The assets of those withdrawing from pension funds will significantly decrease the rate of public debt**. Approximately half of this amount will have an immediate impact on the level of gross debt as the government securities, which have been channelled to the Pension Reform and Debt Reduction Fund, will be eliminated right away. Moreover, the withdrawing members can contribute to the stabilisation of public finances with their employment benefits.

The sustainability of the pension system of the country predominantly depends on two basic factors:

- the rate of employment in the long-term and
- the demographic situation (mortality, life expectancy, rate of births etc..)

In order to increase employment and to stop the decrease of the population several steps have already been taken by the government, which are the following:

To increase employment, the burdens on the biggest sector of employment, i.e. the small and medium-sized enterprises have been reduced by abolishing the so-called "minor taxes", reducing corporate tax from 19 percent to 10 percent, rationalising excessive administrative burdens and restructuring the use of EU funds within the framework of New Széchenyi Plan.

One of the most important elements of the economic policy that encourages the increase of employment is the transformation of the personal income tax system. The system of family allowances that was incorporated into the personal income tax system and taking effect from 01 January 2011 is aimed both at increasing employment and improving demographic situation.

Furthermore, the promotion of part-time jobs, the extension of daily childcare and the more intensive state support allocated to families with children are all aimed at improving the demographic situation and encouraging families to have children.

Conclusion

Regarding the significant proportion of social expenses of the expenses of the state, it can be concluded that even relatively minor reforms can influence the processes of the central budget considerably. The government has taken several measures to make the pension system sustainable and, as a result, to reduce public debt. However, this area requires further reforms for the renewal of Hungary.

Budapest, 23 February 2011.

Ministry for National Economy