

ZSUZSA FERGE

Budget equilibrium and public responsibility
Some social aspects of the New Equilibrium Programme

Over the coming weeks the hot topic of discussion is not going to be long-term prospects but the next three years, and it is not going to concern the government programme but the New Equilibrium Programme, which many have described as the second Bokros package. Few deny the need for the austerity measures, but the opposition generally raise two objections. One of the oft-mentioned issues is clarifying who is responsible for today's situation, and they play up the role of the incumbent government in this. The other criticism levelled by the opposition relates to the "see-saw policy" of the government, i.e. that there are striking differences between the election programme of the government parties and the government programme as well as between the government programme and the Equilibrium programme.

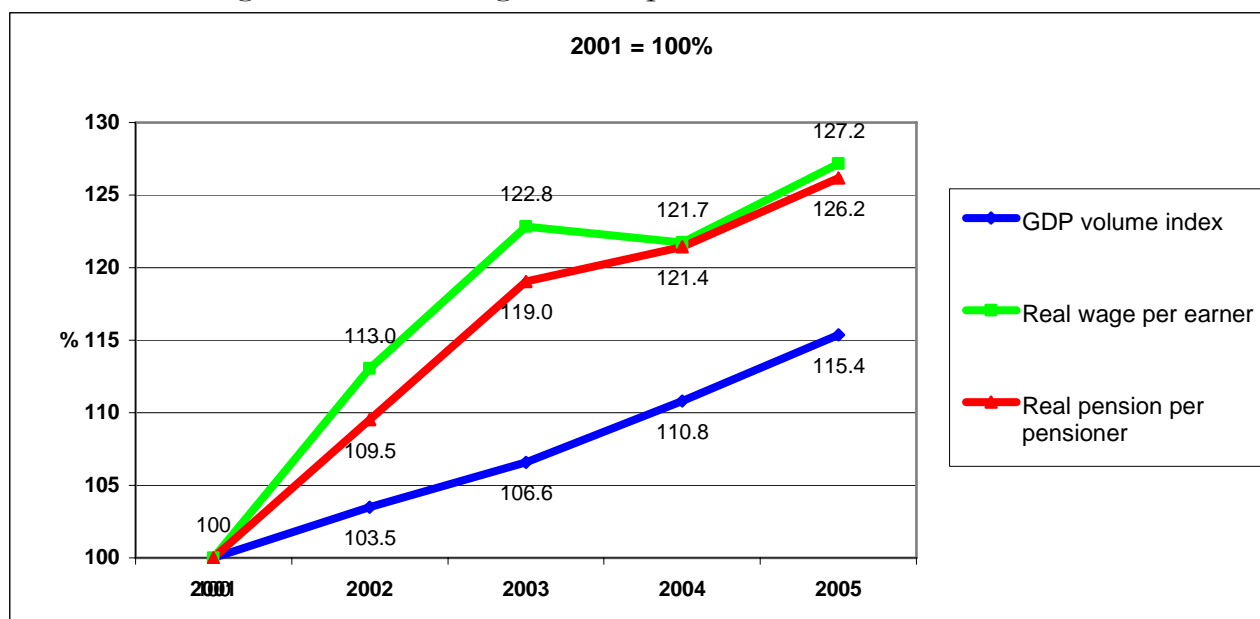
Not even the opposition has doubts any more that the budget equilibrium must be redressed. But they do not want to focus the debate on how to achieve this and on matters of substance. Instead, they are preoccupied by problems of the past as opposed to looking forward, although the real debates will unfold with regard to the latter.

The division of responsibility between governments – particularly the previous two governments – is quite clear. The bank consolidations, the rapid increase in the minimum wage as well as the preferential housing loans between 1998 and 2002 played just as much of a role as the wage hikes for public employees, the motorway constructions or the purchase of the Gripen fighter planes after 2002. The deficit in the social security funds has practically been a permanent thorn in the government's side. However, two other issues can also be debated at length: namely, the extent to which the excessive spending was split between immediate consumption and remunerative investments, and the extent to which the wage increases and welfare spending were wasteful. A reasonably widespread and let's say liberal point of view is that the main culprits were the rapid increases in wages and pensions, the preservation of universal benefits (e.g. family benefit), and the generous welfare spending in general. I would like to detail a couple of facts in relation to these accusations.

Economists love to talk about the overly rapid, economically unsustainable and damaging wage hikes since 2000 as being the principal reason for the problems today. This is often illustrated by means of a graph which depicts GDP growth lagging way behind the increase in wages and pensions. (*Diagram 1*)

Diagram 1

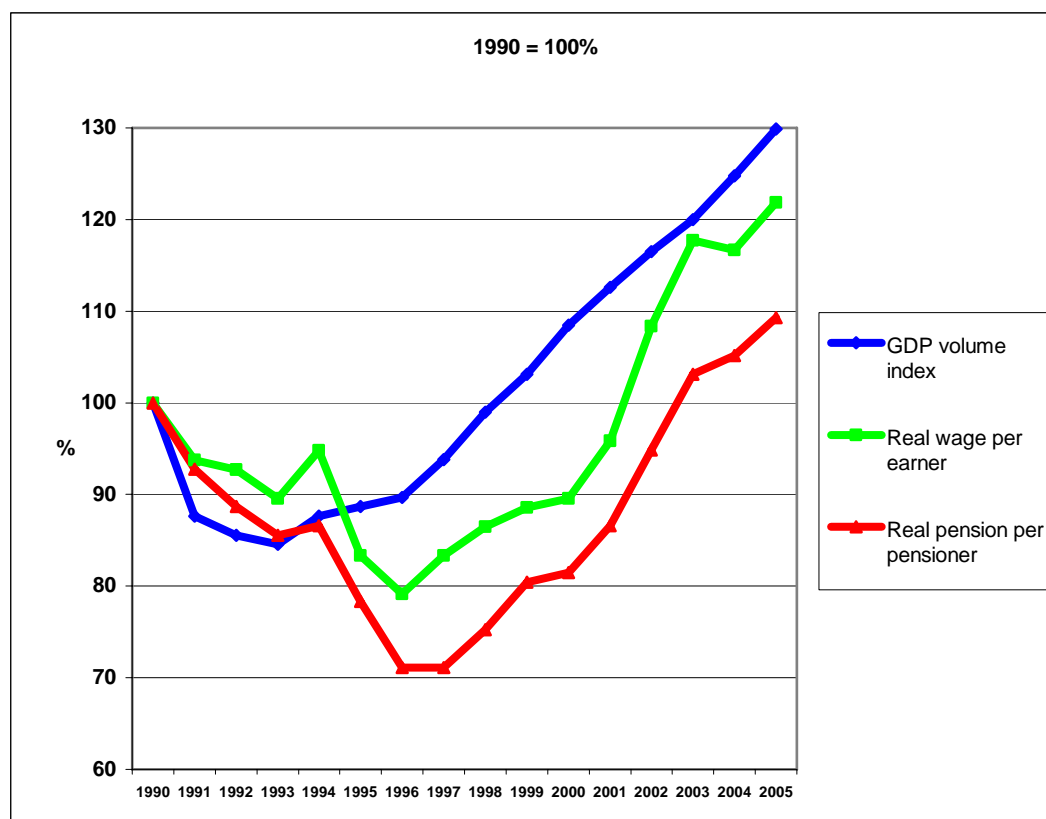
Changes in GDP, real wages and real pensions, 2001-2005, 2001=100



Source: Own compilation based on CSO yearbooks

The problem is that choosing the start year for a particular time series is crucial. If the target is to analyse four years (in either a positive or negative light) then the choice of the start year in *diagram 1* is correct. However, if the question is how things have evolved since the change in political and economic system, what losses were sustained, has the country moved on to some form of sustainable development, or have living standards overshoot means, then the starting year should not be 2001 but 1989 or 1990. But then these figures would lead to a conclusion that contrasts with the previous diagram. After 1990 wages plummeted at a faster rate than the GDP, while after 1994 wages and pensions did not profit in any way from economic growth for a good number of years. The various increases in wages – which incidentally were implemented poorly and suddenly – along with the steadier pension adjustments slowly made up for some of the lag, but even today GDP growth still comes out on top. *Consequently, it is difficult to blame wages and pensions for the squandered GDP.* The GDP returned to its 1990 level in 1998, while it took wages another 3-4 years and pensions a further 2-3 years to catch up. At the same time, the inequality in pensions distribution did not rise to any significant extent, in contrast to wages. The disproportion between the upper and lower tenths with regard to wages at the end of the 1980s was around five-fold, rising to at least ten-fold after the turn of the millennium: unskilled workers fell further behind, while qualified workers and managers soared. It follows inevitably from this that the wages of significant groups of society in recent years have remained below what they earned 15 years ago, despite the frequent increases in the minimum wage.

*Changes in GDP, real wages and real pensions, 1990-2005,
1990=100*



Source: Own compilation based on CSO yearbooks.

Hence the fall in wages and pensions was far greater than that of the GDP and it took a longer time for them to climb back up to their previous levels. This means, in my opinion, that characterising the last 15 years by saying we have frittered away our future, that we ate the goose that lays the golden egg, is a far cry from the truth (though this does not signify that all the decisions made were the correct ones). In light of these figures, the statement in the government programme that "Families have received social compensation in recent years for the huge sacrifices they had to make in the 1990s. The purchasing power of wages and pensions has been increased by one third in four years..." does not ring true. There has been no compensation whatsoever. GDP growth is the result of work, and for a long time – until today as a matter of fact – those who created this added value were not given their just rewards. Perhaps the unreasonable restraint of wage growth was moderated. In any case, the rising wages of recent years do not constitute "compensation" for the lost income over the last decade. In addition to this, wage levels in Hungary fall behind those in Western Europe to a greater extent than prices, and this will only get worse as energy prices increase to global market levels. This gap has caused many problems in the past and will continue to do so in the future.

WELFARE EXTRAVAGANCE OR RISING WELFARE GAP?

Two points of view have been at loggerheads for years. The first states that the Hungarian welfare system has been inadmissibly generous and extravagant. According to the followers of this view, countries in the West know that the "welfare state has died" and they are rapidly reducing their welfare expenditure. These opinions are repeatedly expressed always without supporting figures. They may go as far as the complete denial of the legitimacy or even the existence of the welfare state and the social market economy that underpins it. "The social market economy is purely a political legend, a journalistic idiom with no economic definition. Therefore, it does not exist" – said Péter Mihályi in an interview given in May 2006 to the Magyar Nemzet newspaper.

The other point of view, which I happen to adhere to, is that all of the above is not true. Admittedly there are those in the "West" who would like to bury the welfare systems. Some countries, the Netherlands in the first place, are experimenting with new methods that are much less liberal and generous than before. In most other countries there is a great concern to make their welfare system more effective and cost-efficient, and this may lead to some cuts and withdrawals. However, total public expenditure on social protection or "the welfare state" hardly changes. It is usually maintained on its former level, and sometimes it is even continually raised in accordance with majority public opinion and socio-economic needs. The growth has been significant in the southern countries that joined the EU at a later date (such as Portugal or Spain) and which were "welfare laggard"s. Strangely enough, strong growth has also been typical of Switzerland which was always considered to be the model country of self provision. All the signs indicate that there is now a certain process of more or less spontaneous convergence in this respect, with the only exception to date being Ireland. Amongst other things, the convergence supports the EU principle that there should be no downward tax and wage competition, a hotbed for "social dumping". In 2001 *welfare expenditure relative to the GDP in Hungary was 4 percent lower than the average*. Table 1 reveals the figures for European countries from OECD data. (It should be noted that these figures do not contain some items that are included by the Hungarian budget, namely education as well as the more minor expenditure related to sport, political party or religious activities. The international figures cannot be compared with the figures of the Hungarian budget.)

Table 1

*Public social expenditure as % of GDP
European countries, 1980-2001*

	1980	1985	1990	1995	1996	1997	1998	1999	2000	2001
Austria	22.5	24.1	24.1	26.6	26.7	26.0	25.7	26.1	26.0	26.0
Belgium	24.1	26.9	26.9	28.1	28.6	27.5	27.5	27.2	26.7	27.2
Czech Republic	m	m	17.0	18.9	18.8	19.7	19.5	19.8	20.3	20.1
Denmark	29.1	27.9	29.3	32.4	31.7	30.7	30.2	29.8	28.9	29.2

Finland	18.5	23.0	24.8	31.1	30.9	28.7	26.5	26.1	24.5	24.8
France	21.1	26.6	26.6	29.2	29.4	29.4	29.0	28.9	28.3	28.5
Germany	23.0	23.6	22.8	27.5	28.1	27.6	27.4	27.4	27.2	27.4
Greece	11.5	17.9	20.9	21.4	22.1	22.1	22.8	23.6	23.6	24.3
Hungary	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	20.8	20.0	20.1
Iceland	m	m	16.4	19.0	18.8	18.5	18.7	19.6	19.7	19.8
Ireland	17.0	22.1	18.6	19.4	18.2	16.8	15.6	14.2	13.6	13.8
Italy	18.4	21.3	23.3	23.0	23.5	24.2	23.7	24.1	24.1	24.4
Luxembourg	23.5	23.0	21.9	23.8	23.9	22.6	21.7	21.5	20.0	20.8
The Netherlands	26.9	27.3	27.6	25.6	24.4	24.0	23.0	22.5	21.8	21.8
Norway	17.9	19.1	24.7	26.0	24.9	24.1	25.7	25.8	23.0	23.9
Poland	m	m	15.5	23.8	23.9	23.3	22.0	22.2	21.9	23.0
Portugal	10.9	11.1	13.9	18.0	19.1	18.9	19.1	19.8	20.5	21.1
Slovakia	m	m	m	19.2	19.1	18.7	19.0	18.9	18.3	17.9
Spain	15.9	18.2	19.5	21.4	21.6	20.9	20.3	19.9	19.9	19.6
Sweden	28.8	30.0	30.8	33.2	32.7	31.3	31.1	30.6	29.5	29.8
Switzerland	14.2	15.1	17.9	23.9	25.0	26.0	25.9	26.1	25.4	26.4
Turkey	4.3	4.2	7.6	7.5	9.7	10.8	11.1	13.2	m	m
United Kingdom	17.9	21.1	19.5	23.0	22.8	22.0	21.5	21.2	21.7	21.8
EU-15	20.6	22.9	23.4	25.4	25.4	24.7	24.1	24.0	23.6	23.8
EU-19	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	<i>m</i>	24.0	23.5	23.3	22.8	23.1

Source: OECD. <http://www.oecd.org/dataoecd/56/37/31613113.xls>

Comparative data are not readily available for the last years.. According to OECD analysts, in recent years the trend has continued whereby welfare spending is being sustained or even increased slightly alongside a slow, but steady rise in the GDP. Budgetary figures in Hungary – albeit not strictly comparable with data in Table 1 - follow a similar trend: , the country experienced a slight rise followed by a slow decline in the election year. Hungarian figures (*Table 2*) suggest that the two items which so many wish to reduce – family benefits and pensions – really cannot be touched. Pensions account for a ratio of less than 9% which is low by international comparison, especially given the high number of pensioners (3 million). This is 2-3% higher than in the EU-15 countries. The 1.5 percent devoted to children is not exactly high either, since this indicates the public responsibility that the state bears in the case of one and a half million families as a contribution to the upbringing of more than 2 million children. What must also be noted is that based on the 2004 figures of the CSO, according to the only EU-conform calculation (ESPROSS method) performed to date the difference between the EU average and Hungary is not 4% but 8%.

Table 2

Consolidated functional expenditure of the state budget as % of GDP between 1991 and 2005

	1991	1993	1995	1998	2000	2002	2003	2004*	2005**
<i>Government operating functions</i>	7.8	11.7	6.3	7.4	8.2	8.7	8.1	7.6	7.0
<i>Welfare functions</i>	40.4	40.1	33.6	30.2	28.8	31.1	32.3	31.5	31.4
<i>Of which: educational activities and services</i>	7.3	7.5	6.3	5.8	5.7	6.3	6.9	6.3	6.4
<i>Health care</i>	5.6	5.9	4.9	5.0	4.6	4.8	5.4	4.9	4.7
<i>Social security and welfare services</i>	20.8	21.8	17.8	15.7	14.9	16.0	16.4	16.7	16.3
<i>Of which:</i>	10.5	8.6	8.7	8.3	8.0	8.8	8.7	8.7	8.8
<i>pensions</i>									
<i>Unemployment benefits</i>	0.8	2.4	1.2	0.9	0.6	0.5	0.5	0.5	0.5
<i>Family and child benefits</i>	3.4	3.2	2.3	1.7	1.6	1.5	1.7	1.5	1.5
<i>Economic functions</i>	6.2	6.3	5.6	5.6	5.6	9.4	5.7	5.3	5.7
<i>Public debt management</i>	3.7	4.8	9.7	7.9	6.1	4.4	4.3	4.3	4.0
<i>Other items</i>	1.9	1.8	1.1	2.6	0.3	0.3	0.3	1.0	1.6
<i>Total</i>	53.8	58.4	50.7	48.1	43.4	44.5	45.0	44.4	44.0

Source: Ministry of Finance. Budget data

Note: /* Based on 2004 preliminary data./** Based on plan data for 2005.

Overall, there is still an extremely significant welfare gap between the East and West. We spend less from the far smaller GDP than they do. Bridging this gap and bringing the inequalities under some form of control are not helped by calls for further reductions in spending, or by the clearly "Eastern European" endeavours to unify tax rates. This is well illustrated by the following map, which also shows that although the Baltic States do tend towards a flat-rate system, the undeniable influence from Scandinavia means that their taxes are higher than elsewhere. (Diagram 3)

Flat-rate tax systems in Europe



Source: <http://en.wikipedia.org/wiki/Image:Flat-tax-in-Europe-map.png>

Note: The countries highlighted in lighter red have flat taxes below 20%, while those coloured in darker red have flat taxes above 20%.

The conclusion to be drawn is that the explanation for the budgetary problems is not likely to be found in excess consumption or in the overdevelopment of welfare systems. These are comfortable ideological clichés but have little to do with the current social situation.

NEW EQUILIBRIUM PROGRAMME

The criticism of the huge differences between the election programme and the New Equilibrium Programme (hereinafter referred to as: austerity package) is justified. Although neither the SZDSZ nor the MSZP made too many promises in their election programmes with regard to the next two years, they did not make any reference to such a negative set of measures either. Of course, the difference is far smaller than it would have been between the election programme and the government programme of the Fidesz (who are far more populist than the aforementioned two parties) but this is no excuse. What is also true is that certain differences between the two programmes are customary from a political perspective but they are still debatable on moral grounds.

The other criticism levelled at the difference between the government programme and the austerity package implying that the incoming government did not mention the budget difficulties - does not hold water. Page 5 of the government programme states the following: "The budget equilibrium has to be redressed in the first half of the government's term of office. Over the last five or six years, the justified social and modernisation objectives have not been accompanied by appropriate political responsibility for the budget. Regardless of

the fact that the country began to move away from its path of sustainable growth in 2000-2001, there is no doubt that the greater responsibility must be borne by the governments between 2002 and 2006. Overall we are confronted with a situation whereby the unacceptably high budget deficit is jeopardising the accomplishment of social justice and modernisation programmes. For this reason, after being formed the new government is immediately setting about taking action to redress the budget equilibrium... in the short term this requires a substantial reduction in government spending and a marked rise in revenue." The equilibrium programme just expounds on and specifies this recurring element of the programme.

The justification for the stringent New Equilibrium Programme is widely acknowledged. Yet many details of the programme can quite rightly be criticised, ranging from the method of communication to the rudimentary nature of much of the compensation. The lack of information only increases the concerns. Far more publicity coupled with more explanations, interpretation and argumentation is required to mitigate these worries. What would be particularly important is to find out how those in the greatest need will be protected, even if this part of the package is not completely finished (the temporary compensation for the rise in the price of gas is one such measure, but by itself is insufficient). Public debates could help in avoiding decisions made in haste and the resultant failures and setbacks, as well as in finding better solutions. But the government is generally overhasty in other areas too which do not appear in the package. On 17 June the Magyar Hírlap newspaper published some of the changes in health care which will take effect from 1 July. One of these changes states that "if a patient could have been treated as an outpatient there was no point in the individual going into hospital as only the outpatient fee will be paid." Without being an expert in the field I am sure that this requirement is nonsense, For instance, there are no general protocols which clearly specify when this or that treatment is justified. This is likely to open the door to innumerable legal actions. What is more, in many cases it would be safer for patients to stay at home if there were a properly organised home care service with an appropriate nursing network. This service is not even enough to satisfy the far narrower demands of today. The planned austerity measures are not only going to severely affect hospitals from the beginning of July but also patients. Here it is also blatantly clear that narrowing the scope of services does not constitute a reform, and that investment has to be made before many savings can be achieved later on.

The situation is similar for the rise in the price of natural gas and energy. Three options have been outlined so far in terms of compensation. One of the proposals recommends the introduction of a progressive gas price according to the level of consumption: those who consume more should pay a higher price, which in all likelihood would be set in "bands", just like taxes. The second concept favours using social allowances to compensate for the rising burden placed on those in need, as opposed to modifying the pricing system. The third proposal also recommends some form of progressive gas price but this would not be based on consumption. Instead, the gas price would be linked to the level of income-based

hardship. The price would be differentiated in accordance with the income of the family and the number of family members, using a formula based on some unit of consumption.

It would be worthwhile debating these options publicly. Arguments abound. For instance in today's electronic world there is absolutely no technological barrier to introducing a progressive gas (electricity, water) tariff. There is precedence for this abroad, principally in the case of water in countries where supplies are low. Sándor Kopátsy made such a recommendation years ago. Introducing the system is inexpensive and efficient, especially if the tariffs rise in bands. It encourages economical use and if the price of the first band is set intelligently it can actually benefit the poor. I think this is an acceptable solution although it does have its drawbacks. Perhaps its greatest shortcoming is that it does not take into account the higher minimum consumption of large families. In principle this is feasible, only the number of children or the number of family members has to be integrated into the tariff calculation. Nevertheless, I do not think this is an ideal solution. It inevitably involves frequently controlling families through family visits. The second option would resolve the problem of the number of children: the method of compensation would be a corresponding rise in child benefit or some form of separate compensation in proportion to the child benefit. The advantage of this latter method is transparency. Though admittedly, as happened previously with the separate milk or meat supplements, this sooner or later will be integrated into the child benefit, by which time the price shock will have subsided.

In my opinion, linking the price of gas progressively to income is absurd. Verifying income levels is one of the most costly methods of administration. It is always inaccurate, can always be challenged, is always a major interference in private life, causes tensions even between neighbours and what is more, income constantly changes. Each tangible increase or decrease in income (loss of job, relocation, sick pay, etc.) would require new certificates which would have to be channelled through the energy service providers, etc. Nevertheless, regardless of how damaging I believe means-tested aid and subsidies, in this case there is certainly a need for them. The compensation system has to be supplemented for those who do not benefit from an increase in child allowance because there are no children in the household, but who are still in need of help as they do not have enough money to pay the bills. One possible solution here would be to expand the housing subsidy system in this respect, which of course is linked to verifying income but at least it is a functional and to a certain extent tried-and-tested system. There could be some normative elements which are clear and predictable, coupled with other aspects that can be adjusted to individual living circumstances relatively easily.

I will not continue dissecting the advantages of public debate on the methods of compensation, for the simple reason that two requirements that I also support conflict with one another. The first is the requirement for rapid assistance, while the second is the need for a method of compensation accepted by the public. There is little chance of identifying something that is quick but which is also the

product of a democratic debate. A possible solution here would be if rapid assistance were provided but which is declared from the outset to be temporary and can be modified following public debate.

But what is indispensable for providing rapid assistance is if we know and if the government knows who needs help. It is already clear that there is an extremely weak correlation between the ability of individuals to pay taxes and levies and the volume at which they can make their indignation and outcry heard.

INTENDED IMPACT OF THE AUSTERITY MEASURES

For the time being only the government's first intentions can be gauged. The elements of the package are changing continuously depending on the extent to which interests can be asserted, while their implementation will depend on the ability of those opposing the measures to circumvent the law. But the intentions are significant and they at least reveal something about the policy of the government. There are few known estimates about the possible social impact of the package. Up to now the most detailed estimate calculates the impact on two or three groups, the state, capital and labour (or just the state and citizens). There is broad agreement that the burdens of the package will be shared between the state, capital and labour at rates of 30%, 20% and 50% respectively, although the "correct" distribution would have been an even split. I cannot check this calculation, but the groupings themselves do raise some doubts. The burdens are not borne by the "state", but instead by those who will be affected by the cost-cutting in the public sector, for example through downsizing. "Labour", i.e. those in employment, is not a homogenous group either, especially not a homogenous group of the poor. There are some extremely highly paid civil servants and managers as well as those who really do live from the minimum wage. There are also other people living in the country who do not belong either to labour or to capital because they have neither job nor capital. It seems preferable to make a social impact analysis by groups categorised in terms of incomes or living standards.

From this perspective the population can be divided into four large and reasonably well-defined groups. These are the poor, the insecure lower middle-class, the stable "upper" middle-class and the wealthy. The poor category comprises around 1 1/2 million people accounting for 15%. All of these people live below the minimum subsistence level calculated regularly by the CSO. Many of them include large families, the long-term unemployed, those working in the black economy, people who are psychologically and physically ruined, those struggling with major debt and those living on the streets without any home and leading a life of poverty. The Roma account for approximately one third of this category. It is no longer possible to take anything away from the poor without there being disastrous consequences on adults and children.

35-45 percent of the population (let's say 40%) who are slightly better off are also in a worse, more insecure and tighter situation than before the transition. They did not yet sink but are barely able to keep themselves afloat. Many of them are

already struggling with debt, but with a bit of help they are not a lost case. A relatively high proportion of large families and pensioners fall into this category, along with a fairly high number of weak-performing small enterprises, out of whom many are “forced entrepreneurs” (those starting a private venture because they had no other option) This group can barely take any more burdens.

The two upper groups – the stable middle class, which accounts for around 35 percent of the population and the wealthy who constitute another tenth – have above-average resources, influence, information and opportunities to exert pressure. The significance of this becomes quite clear if we look at the proposed "bank tax" – hardly a matter of life and death for those concerned – where the group affected had it taken off the agenda in just one day by making reference to public interests jeopardising the economy. The interest tax that took its place, totalling HUF 25 billion instead of HUF 50 billion and which does not affect insurance companies was described by Raiffeisen bank analysts that day as "suicide". In reality, both of the two upper groups have benefited significantly from the change in political and economic system. Both groups are very well capable of handling even a significant rise in payment burdens. *Table 3* summarises the information on the population and income distribution based on statistical data. The last column in the table is my own assessment of each group's ability to bear further burdens.

Table 3

Distribution of population and personal incomes between groups categorised by income and living standards (2005 figures)

	Percentage of population	Approximate share in total personal income (%)	Potential to bear higher burdens
The poor	15	5	None
Insecure, lower middle-class	40	29	Practically none
Stable "upper" middle-class	35	41	Moderately high
Upper classes, wealthy	10	25	Strong
Total	100	100	..

Source: TÁRKI, CSO, ELTE Poverty Research Centre data, own calculations.

I could only hazard an approximate estimate for the distribution of the financial implications of the programme between the above groups. I analysed each measure of the package individually (roughly 30 separate measures) to see how the various classes were affected. For example, the impact of the hike in VAT was largely divided proportionally between all of the groups since the goods in this category are essentially consumed by all. In terms of the gas price hike I did not take the

compensation into account, but I did include the fact that the two groups in worse-off situations consume relatively less than those who are more affluent. The increase in employee burdens or the simplified entrepreneur's tax (EVA) increase were primarily assigned to the two middle groups, since there are few employees and small entrepreneurs among the poor and the wealthy. The levies targeting property and high incomes were assigned mostly to the two upper groups. The estimates are debatable but can be checked. Based on the distribution of their joint impacts the austerity package seems to have endeavoured to share the burdens as equitably as possible. In this respect it differs radically from the Bokros package in 1995. The poor and the lower middle classes suffered the most from the direct impacts of the Bokros package. Public opinion only remembers now that the Bokros package "took away" child benefit from wealthy families. What people have forgotten is that unemployment benefits were cut drastically and sick pay regulations were tightened, or that in 1995 the personal income tax for annual income up to HUF 110,000 was zero, but one year later in 1996 it was 20 percent.

The impact of the current austerity measures follow the income distribution ratios to some extent. In the two lower groups there seems to be perfect harmony with regards to their share of income and the burdens. The upper middle class are slightly "over burdened", while the most affluent group are a little under burdened, but these differences are no greater than any potential estimate error. (*Table 4*) Yet the distribution which is seemingly proportionate to income is not reassuring. The poorest in the population can certainly not bear even this much, while the apparently proportionate burden on the lower middle class implies the risk that many of them will fail to cope.

Table 4

Distribution of incomes and the financial impact of the austerity measures planned for 2007 between groups categorised by income and living standards

	Distribution of total personal income (%)	Estimated split of financial impact of austerity measures	Burden compared to ability to bear costs
The poor	5	5	Clearly too high
Insecure, lower middle-class	29	28	High, difficult to handle
Stable "upper" middle-class	41	43	Acceptable
Upper classes, wealthy	25	24	Barely noticeable
Total	100	100	

Source: TÁRKI, CSO, ELTE Poverty Research Centre data, own calculations.

It is extremely important in the interests of the poor and the groups in insecure situations to think through the possible means of compensation now, and to provide them in good time. Those who lost the most from the system change really do have to be spared from further losses. Especially since the budget deficit entailing the present austerity measures is largely due to public expenditures (motorway, housing loans, student loans, etc.), from which the worse-off have never benefited at all.

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