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# - The Politics of the Hungarian Pension Reform.

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Abstract:

The pension reform has been on the agenda for over a decade because of some basic flaws in the system. Since any change would have entailed the curtailment of existing rights, all (pre-and post transition) governments were reluctant to make radical moves. Only ad hoc and partial measures were taken. In 1990-94 the policy of 'stealthy erosion' was followed, lowering the standards and changing the structure of pensions without any new measure. The reform was emphatically put back on the agenda in 1996, and the new Laws were adopted in July 1997. The paper will try to identify the role of the various actors: the Ministry of Finance , other government agencies, financial lobbies, the MP-s, the Trade Unions, and some civil organizations. The conclusion is that some crucial actors have remained almost invisible, that the reform corresponds to the interests of the financial lobbies and of better-off strata, and that the voice and strength of 'civil society' had been weak. The procedure of the enactment of the laws respected all the formal rules of democratic government. Yet the wide-ranging and patient consensus-building that is the substance of democracy was defective.

## The background

The history of the Hungarian public pension system started in 1912 with a budget-financed scheme for civil servants. It continued with a more general scheme (Act XL of 1928) for employees (workers) in trade and industry (not agriculture). This system was funded and operated with a governing Board until 1950[1]. It had hardly started to pay benefits before it was transformed into a pay-as-you-go and state-managed system soon after the war. The coverage of those in the 'active age groups' was under one third in 1940. It increased steadily from 1950 on. Pensions reached relatively acceptable levels only from the mid-seventies on. The

[1] The Hungarian pension scheme was directed by a self-governing body, a representative board, 'Önkormányzat' in Hungarian, also before the war. This governing body - called hereafter Pension Board - assured the relative independence of the Fund.

replacement rate increased from 22 per cent in 1950 to 56 per cent in 1985, reaching a peak of 66 per cent in 1990. Since then it is slowly declining again. (It was 61 per cent in 1995.)

Meanwhile the incremental and haphazard changes blurred the principles of the scheme. There was growing awareness of these problems. A research program on social policy, carried out in the early eighties in the Institute of Sociology of the Hungarian Academy of Sciences had made already a series of reform proposals. It recommended, among other things a clearer relationship between insurance and solidaristic principles; the return to the independence of the pension fund under a Board; a three pillar scheme composed of a universal, budget-financed minimum pension, a PAYG scheme, and voluntary private (or mutual) schemes. (Ferge-Péteri, 1985 and 1987). These proposals were engulfed by later history. But these and other contemporary criticisms prove that it was an open secret for many - including the experts of the Directorate of Social Insurance - at least from the early eighties on that the pension system was obsolete, parsimonious, incomplete and unsustainable at the same time, full of iniquities and inconsistencies, and in dire need of reform.

**Reluctant changes affecting the pension system after 1989**

The last ‘socialist’ government adopted some reforms in the last months of its existence. Thus the Social Insurance Fund (covering then practically all benefits in cash) was separated from the state budget *in 1989*. In early *1990*, some months before the elections, a proposal for an independent pension scheme was discussed by a Parliamentary Committee. Because of the pressure of the then unofficial opposition - which feared the monopoly of the unique trade union - it was, however, postponed. Other proposals were adopted and implemented in April 1990, however. The family allowance was made universal and moved from the insurance fund to the state budget. At the same time the financing of health care, albeit still a public scheme, was transferred from the budget to the Insurance Fund. These moves paved the way to many later changes of the pension scheme, a process called the ‘cleansing of social insurance’.

In *1991*, the Parliament adopted two important decisions in respect to the pensions. One of them determined the orientation of the would-be pension reform. It projected a three-tier system, namely a basic flat-rate scheme, a compulsory earning-related scheme, and a voluntary, private tier. It also foresaw the increase and flexibilization of the pension age. This decision was followed by legislation in a slow, fragmented and piecemeal way. The other decision aimed to secure the financial position of the insurance fund by transferring to it a large chunk of the still unprivatized state assets. This decision was delayed so long that the original commitment could not be fulfilled.

In *1992*, the main gain was that the Parliament ruled that the pensions should be regularly indexed to wages. In the same year the public health service was transformed into a compulsory insurance scheme, and switched from tax-based funding to funding through insurance contributions. The Social Insurance Fund was then split into two autonomous funds (one for the pensions, the other for health). As an interim solution until the election of the Boards, they were supervised by Supervisory Committees nominated by the Parliament. The 'cleansing' of the pension insurance continued, shifting back to the budget pension provisions connected to unemployment and to political rehabilitation.

The need for civil participation and control over the funds in the form of an elected Board remained continuously on the agenda. It was strongly resisted by the first, conservative government. Yet, at this time civil society was still relatively active and enthusiastic, so that the movement for the Pension and the Health Board ended with a nationwide poll in the Spring of *1993*, with almost 40 per cent of the citizens taking part in the elections. The representatives of the trade unions were elected, those of the employers delegated by their organizations. This is not the place to evaluate these Boards, but some short comments may be useful. The Pension Fund and its Board functioned relatively well. The performance of the Health Board was, to say the least, moderately successful. The switch from a public health system to insurance entailed a sweeping slackening of all the rules and practices. The changes in financing, large-scale privatization, new rules in management, etc. offered too many opportunities for well-organized lobbies, and even for small-or large scale corruption. The health system deteriorated both because of too many sudden administrative changes and decreasing financial provisions. Thus the Health Board acquired (with more or less justification) a bad reputation that undermined to some extent the legitimacy of both Boards.

The only other move made by the parliament in 1993 was the enactment of a law allowing the creation of voluntary private pension funds, with very important tax breaks.

In the next three years legislation about the pension system did not progress. Quite a few things happened, though, behind the scenes. The IMF and particularly the World Bank had become very active in pressing for a 'genuine' pension reform. Until about 1992, the reform proposals of these supranational agencies did not go further than those suggested long before by the Hungarian experts themselves. The main difference was that the supranational agencies censured the increasing usage of some form of retirement (early retirement, disability pensions) as a means of handling lasting unemployment, while this solution was seen by many home experts as a lesser evil than condemning aging and unhealthy people to turn to the uncertain and inadequate unemployment assistance schemes.

From about 1992 on, conflicting views emerged. Over and above the discord about the age limit, opinions clashed on two issues. One was the form of funding: whether a funded or a PAYG system would be more appropriate. The second

collision appeared with the imported idea that compulsory privatization could, or indeed had, also to form part and parcel of the reform.

## The difficult road to the 1997 pension acts

### *a) The pension age*

The law adopted in 1996 increased the age limit to 62 years, to be fully implemented for both sexes from January 2009 (Act LIX/1996). The resistance to the increase of the pensionable age was extremely strong, particularly on the part of the Trade Unions. This does not seem to be exceptional. Similar anti-reform movements have developed in most western countries connected to the rise of the pensionable age. There are many explanations I cannot deal with here. Let me just mention that the resistance in Central-Eastern Europe - while economically not rational - seems to be sociologically more understandable than that in the West.

As for the economic irrationality of the low age limit for instance in Hungary, one has to take into account not only the low official limit age-limit (60/55), but also the even lower actual retirement age (54 years for men, and 52.7 for women in 1994). More importantly, the loss of jobs, early retirement etc. decreased the number of contributors, while the number of pensioners swelled. As a consequence, a practically unsustainable dependency ratio emerged: one hundred contributors had to finance the pensions of 57 retirees in 1990, and 70 in 1994.

The reasons of the resistance are not less convincing. (i) The health status of people, young and old, is worse than in the west; (ii) life expectancy is shorter even above the pensionable age limit[2]; (iii) the future is even more uncertain: unemployment benefits are highly inadequate so that early retirement helps to avoid the immediate misery in old age. During the preparatory debates the opponents of the reform obtained some compromises. For instance the rules of retirement have become slightly more flexible (mainly because of the pressure of trade unions), or the years of maternity got more recognition (due particularly to the Association of Large Families). The current legislation is by now accepted albeit not without frequent complaints.

### *b. The preparation of the structural reform - proposals and counterproposals*

The idea of a compulsory *public funded pension system* was well-known in Hungary. It was also common knowledge that there were compelling reasons -- political and economic cataclysms, that is war losses and astronomic post-war inflation -- which had led to its replacement by a PAYG system. *Voluntary private*

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[2] The average life span of Hungarian men is *6 to 10* years less than in more developed western countries. This is due particularly to the very high mortality of the younger (35 to 55 years) male cohorts. Thus if one reaches the age of 65, the difference between eastern and western life spans decreases *to 2 to 4 years.*

*pension funds* had also existed before the war, and their reintroduction in 1993 was favorably greeted. The combination of these two familiar solutions, namely a *compulsory privatized* saving scheme represented, though, for many a disconcerting innovation.

The campaign of the World Bank for privatization (at least the part of it that became known to the public) has started in 1992, with seminars taking place in some countries in the region. (The first of them was probably the one organized in Hungary.) It was followed by the publication of a major Policy Research Report of the Bank in October 1994 entitled 'Averting the Old Age Crisis', and by the campaign preceding the publication. One of the major heralding events was a meeting organized jointly by the Bank and the IMF in August 1994 to present the main ideas of the Report to officials from 39 countries (FMI Bulletin 1994, Beattie et al, 1995). The contents of the World Bank proposal is a multipillar system with the following elements:

- *Pillar* 1 - a mandatory pay-as-you-go public pension system designed to provide an income floor for all elderly persons
- *Pillar* 2 - a mandatory funded and privately managed pension system...based on personal accounts (the Latin American Approach) or occupational plans (the OECD approach)
- *Pillar* 3 - a voluntary system (also funded and privately managed), with strong government regulation, to provide for additional savings and insurance (Fox 1997:375)

In other words, in this scenario the role of the state is reduced to the regulation of the private funds, and to a safety net for those unable to fend for themselves. The story of the five years of the pension reform in Hungary -- from 1992 to 1997 -- is woven around the implantation, the constant reshaping, and the gradual acceptance of this idea.

As far as I can reconstruct the story, the Hungarian experts first met with the proposal for the compulsory privatized scheme in late 1992 at a regional seminar organized with the active participation of the World Bank. At this point most of the Hungarians dismissed the plan as sheer lunacy, foreign not only to the Hungarian, but also to the European tradition[3]. They shared the opinion that a 70 year old system which performed rather well even in the extremely hard years after the

[3] Mandatory 'universal' private schemes (that is mandatory for all employees) completing mandatory public schemes have not been unknown in Europe. They have been introduced more or less recently in France, Sweden, Switzerland, and with more limited coverage for instance in the Netherlands and some other countries. But either they have weak individualized elements (like the 'Mutualités' in France), or little market freedom (Sweden), and/or had been introduced under stable economic conditions, with a dependable banking and insurance sector (Netherlands, Switzerland) (Voirin 1995).

transition[4], while needing overhauling, should be consolidated in the interest of present and future pensioners rather than dismantled. Still, the unsustainable and confused system required *some* reform.

The government, the Pension Board, and the more or less independent experts started to work seriously on the reform towards the end of 1994. A government decree in December 1994 set up the Committee of the Reform of the Treasury (Grand Committee hereafter) directed by the Minister of Finance , manned by top politicians and experts. Within this framework seven subcommittees were set up. One of them, the Subcommittee on Welfare, had as one of its tasks the preparation of the pension reform. It presented the first comprehensive reform plan to the Grand Committee in June 1995. (The characteristics of this plan will be detailed below.) The proposal, accompanied by data derived from macro-simulation models (Augusztinovics in Bod, 1995) was received quite favorably at this point by the members of the 'Grand Committee'. Still, for reasons understood only much later, this proposal was *never presented to the government*.

In 1995 the breach amongst the Hungarian experts had become manifest. The 'neoliberal' economists and politicians, as well as the staff of the Ministry of Finance had become converts of the private-funded solution. Thus the first reform proposal prepared by the Grand Committee presented to the government in the summer of 1995 contained - among many other items - a brief pension reform plan which *differed radically* from the one discussed, and by and large approved of, by the same body in June. It introduced (without any previous consultation with anybody involved in the reform operations) the idea of a funded privatized pillar, assigning to it a decisive role. Exact figures of the percentage to be privatized had not been given at this point.

The Ministry of Finance espoused this proposal. Its confidence was probably heightened after the publication of the report on Hungary of the World Bank (released in Autumn 1995, World Bank 1995) which, albeit with many caveats, reiterated the firm conviction of the Bank about the necessity of a private pillar[5]. Also, it was probably about that time that the World Bank became directly involved in the Hungarian reform at the request of the Ministry of Finances. One form of help was the invitation of experts from countries with experiences in private schemes (Australia, Argentina, Chile, the Netherlands, Switzerland, the United Kingdom or the US). In all of the invited countries the history, the

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[4] It has been shown that in the CEE countries the pensioners had not been among the main losers of the transition because the existing pension systems continued to function much better than many other administrations. Yet, their situation has become rather difficult because of the increasing prices of the basic necessities, of reduced extra job opportunities, and so forth. See e.g. Ferge and al. 1995, for Czechland, Hungary, Poland and Slovakia.

[5] The same caution characterizes quite a few reports of the World Bank on the South American pension reforms approved of, or encouraged, by the Bank itself (e.g. Vittas 1995a and 1995b).

economic and political conditions, as well as the evolution of the pension system were significantly different both from the European mainstream and from those of Hungary. Significantly, the leader of the team of the Ministry of Finance has been for years an 'émigré' working in the private financial world abroad, or that an American actuary was invited by the Ministry in 1996 -- while they never even consulted the Hungarian actuaries.

The Ministry of Finance argued for the introduction of the funded pillar invoking it as a means of assuring more freedom of choice to the citizens; of strengthening individual responsibility; of deepening and developing the capital- and stock-market; and of boosting economic growth by a higher rate of savings. One of the main arguments was that if people could follow the fate of their contribution, this will give an incentive not to evade payment. It was continuously emphasized that 'one saves for oneself and one's beloved ones', because the private saving may be inherited; that the private pillar was safer than the public one; and that nobody would lose with the switch.

Turning now to the details, the first version proposed by the then Minister, Bokros, was a fully funded private system. The next version was the halving of the scheme, with fifty percent of the contributions going to the private pillar. After further debates this rate decreased to 30 per cent.

During 1995 and early 1996 the Pension Board and the Ministry of Social Welfare also worked out their proposals. Originally, these proposals differed from that of the Ministry of Finance. Rather, they closely resembled those of the Subcommittee. First of all, they declared that the first function of a pension system was to serve the aged and not to boost growth; that the voluntary funds probably served better the aim of saving than the mandatory scheme; that transparency and equity could be introduced also into the public pillar; that the idea of inheritance was built into the public fund through the provisions for widows or orphans, albeit not based on an individualized, but a solidaristic (and usually more generous) principle; and that the forecasts were inevitably uncertain.

These proposals aimed at maintaining the PAYG system but with basic corrections. They advocated clearer, less opaque rules for calculating the pensions; a neater distinction between insurance principles and solidaristic principles; a more correct relation between contributions and pensions by means of a scheme akin to the German system of 'points'. A relatively high ceiling (2.5 or 3-times the average wage) was supposed to yield an acceptable replacement rate. The increased inequality of pensions was foreseen, but it was argued that a basic pension pitched at a relatively high level would mitigate this problem.

The counter-proposals were never made properly public. The relative advantages and disadvantages of the two plans were never presented clearly and objectively to the general public. The proposal of the Ministry of Finance was given more attention than the others. It was presented for debate as the *single valid solution* to expert groups, to some scientific bodies, and to some accepted political

partners. At all these occasions it was heavily contested. The critiques led to some compromises in the 'official' version.

The highly controversial commitment to privatization was not abandoned, only its weight was reduced. When the ratio of the projected private pillar decreased to thirty per cent, the Ministry of Welfare gave up its former recalcitrance, and made its compromise with the Ministry of Finance . It was joined by the other interested Ministries (those of Justice and Labor). With this support, the government changed its tactics. A government decree in May 1996 ruled that the basis of the farther reform work should be the inter-ministerial proposal. It reorganized the arrangements for the preparatory work on the pension reform. Declaring that their task was completed, it dissolved the Committee of the Reform of the Treasury and its Subcommittees, and concentrated the work in a new unit in the Ministry of Finance, inviting to it 'ideologically reliable' experts.

From then on, the main resistance came from the Pension Board, some experts, and, as a new element, some civil organizations. Despite the reluctance of the government to inform and to involve the public, information about the government proposals started to spread. The various trade unions, women's organizations, the Council of the Aged formed by the prime minister in December 1996 (Széman 1998), a group of young researchers, the Party of Pensioners, the Association of Large Families, the Association of the Social Professions, the Social Policy Association, various groups of experts started to voice criticisms. The impact of these actions was, however, small: the voice of 'civil society' got little publicity in the media, and remained largely unknown to the general public.

One may of course wonder why no civil organization took over the task of informing and mobilizing the public. The main reason is that they did not have the necessary material and symbolic resources: these remained concentrated at the Ministry of Finance and have been used in a one-sided way. Also, the time allowed by the government to consult citizens was too short to start a successful information campaign. As a matter of fact, the better opportunities and resources of the Ministry of Finance -- in fact, its exceptionally powerful position -- had a dominant impact on the whole process of legislation.

### The legislation: Summer 1997

The legislation process gathered momentum in 1997. This happened despite the absence of public debates and despite the continued opposition of the experts as shown by the records of the Conference on the Pension Reform in February 1997[6]. Many concrete questions of the opponents (requiring for instance exact calculations

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[6] The 'statistics' of the Conference represents well the situation even if the sample is very small. There were 33 participants. 5 experts or politicians did not have a fixed preference. 10 were committed to the proposal of the Ministry of Finance , and 18 argued against it.( *Nyugdíjreform konferencia,* 1997)

about the additional costs, reliable forecasts based on micro-and macro simulation models, and so forth) remained unanswered up to the end. Yet, the government succeeded in forging a compromise within the National Council for Interest Adjustment. The compromise made the original government proposals milder on some issues without changing the essence of the plan. (For instance the tightening of the conditions of disability pensions was posponed; the state guarantees of the private pillar were expanded, stc.)

The Parliament started to debate the draft legislation on May 28, 1997. The government deposited simultaneously five drafts: on the general framework and financing of social insurance; on the public insurance system; on the private funds; on the mandatory health insurance; and on the amendment of the Social Act (introducing social assistance for the elderly). It imposed a limit of 30 hours (later increased to 40 hours) on the time consecrated to the 'general' debate in order to get through the voting procedure before the end of July, so as to start the new system on January 1 1998.

The closer analysis of the parliamentary debate is rather depressing. There were over 400 proposals of amendments to the draft laws, but few of them touched essential issues. Only a minority of the MPs were present at the sessions, and few of them familiarized themselves with all the intricacies of the draft laws. Much of the general debate remained on a highly ideological level. The technically informed proposals referred mostly to the new, private pillar. Very few MPs realized the impact of the reform on current and future beneficiaries of the public scheme in the next two or more decades.

At the end even the limited time allowed to the Parliament proved to be almost too long. The voting *on all five Acts* took place on the 15th of July (instead of the end of the month), and all of them were adopted with a relatively slight margin (55 to 58% of the votes). The opposition parties voted unanimously against the Acts.

The five laws enacted in July 1997 together with the Act on Mutual Funds dating back to 1993 have produced a system consisting not of three, but of four pillars. The '*zero*' pillar is a means-tested benefit 'for seniors', i.e. for those who did not acquire sufficient pension rights. The *first* pillar is a slightly reformed, compressed, hardly improved PAYG scheme. The *second* pillar is a private funded defined contribution scheme that is mandatory for first entrants to the labor market, and optional for everybody else. The *third* pillar is the voluntary private pension enacted in 1993, implemented in 1994.[7]

The parliamentary procedure suggests that the MPs realized from the very beginning of the debates that the government was immovable, and - because of its majority in the Parliament - would be able to force through the legislation. These events contradict to some extent the slightly complacent evaluation of the minister

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[7] For more details see e.g. Simonovits and Müller in this volume, Rocha and Palacios 1996.

of Finance on this issue. He explained in September 1997 that the pension reform took a lot of the energy of the Ministry and the government, because ‘the social impact of such a reform is so prolonged that it can be adopted only after a thorough process of interest adjustment, and with a large parliamentary majority’ (Bossányi 1997). Unfortunately, in reality the broad consensus was not sought, and the Acts were not adopted by a large parliamentary majority.

## Some - perhaps unjust or undue - qualms

The pension reform is a huge success among the citizens. As figures presented later will show, the number of rapid joiners exceeds by far the original expectations of the Ministry of Finance. The misgivings voiced hereafter may therefore be seen as signs of the envious malice of a loser. However, the present success may not be built on very solid grounds, and its costs largely ignored by the advocates may be rather high. Therefore the formulation of doubts or misgivings may be justified.

### *Is any amount of brainwashing with taxpayers money permissible?*

* The Treasury started a PR campaign - paid of course by the budget from tax-payers money - that is geared to *build up confidence in the private scheme and destroy confidence in the public scheme*. Since last July for instance quarter-page advertisements appear in all major newspapers. The central figure of the publicity stunt is a charming little boy walking ahead on a road leading apparently towards a radiant future. The headline and the legend are changing. A small sample of them is worth quoting (with emphases added):

> July 1997: Headline (**H** in what follows): ‘***Who is paying the bill?***’ A quotation from the legend (**L** in what follows): ‘When there is a multi-pillar scheme *the elderly are not forced to be burdens on others’*.
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> September 1997: H**:** ‘***The old pension system goes on pension’***. The legend is about the huge amount of money Tom Smith, an everyday young man will earn when skillfully choosing a fund. ‘From January a new pension system will be introduced in Hungary. Its aim is to assure that the pension of Tom Smith will cover more than his mere survival ...He may pay a part of his contribution in a private fund *to earn more money*...not only for himself, but for his children...Because *this money will be inherited*, together with the interests’
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> February 1998: **H:** ‘***My grandfather is the cleverest pensioner’***. **L:** He says among other wise things that ‘Once upon a time they said that people will get what they deserve. Today they get what they can obtain from their economies’ by skillfully using the market opportunities.

> April 1998: **H:** '***My dad sees the future'***. This wise father gathers all the information from the funds, asking them about everything including their experience with money dealings at home and abroad. 'My dad says that it is better to clarify everything in advance *to prevent that, at the end, I were obliged to support him.'*

The values suggested (the rejection of supporting the parents, the devaluation of desert or merit or work) are, to say the least, hardly compatible with a European value system. The most dangerous message is, though, that 'the old pension system goes on pension'. According to the law, this system is meant to cover three fourth of the pensions in the foreseeable future; all disability pensions; and the guarantees if the private system fails to deliver the goods. The message discourages all effort to improve the public system by disparaging, and sometimes by abusing it. Yet this system is in bad need of corrections. Its earlier defects were only partly remedied, and the reform introduced new deficiencies.

***Contradictory or truncated arguments of advisers***

* (*Unsustainability*) One of the most often evoked topics is that the current system is unsustainable in Central-Eastern Europe. 'PAYGO systems unworkable' claims a fat sub-headline of Transition, a Newsletter of the World Bank (Fougerolles, p.4.) The crux of the argument is the already mentioned fact that the system dependency ratio is unbearably high. The catch is that the *only* remedy offered here and elsewhere in similar documents is privatization. The basic issue - that we need much more (legal) jobs - is hardly raised.

* (*The extolled models*) Townsend and Walker (1996) may be right. By now all the transition countries know much more about Latin America, Chile in particular, Singapore, Switzerland and the Netherlands than about all the other European schemes closer to them historically, socially and geographically. It is particularly disturbing that the most influential advisers present a highly truncated or stylized picture of the Chilean success-story.
This assessment is taken over by the partisans of the reform in the Eastern countries.

> The example (for the Hungarian reform) may be Chile.. Fifteen years ago amidst conditions of similar economic slump and a similar political and economic paradigm change ..a much more radical pension reform was introduced...In the following both the Chilean economy and its pension funds showed spectacular development, producing two-digit yearly growth rates or rates of return (Holtzer p.47).

The parallel between the new democracies and Pinochet's dictatorship in 1981 in Chile is disturbing to say the least. The banalization or neglect of some basic facts is irritating. Balanced assessment (Kritzer 1996, Myers 1995) mention the high costs, the fact that only about 55% of the affiliates actually pay their contributions, the likelihood that low wage workers and women may not benefit from the scheme.

* *(Advice or pressure?)* Ill-informed or unfounded censures of the former system are one of the bases to give authoritarian advice. Bastian (1997) finds for instance that one 'of the key deficits of the present pension system' is 'the indexation of benefits, generally based on the rate of wage increases'. In fact, the former regime ignored indexation that was introduced thanks to the new democracy, and among other reasons on the advice of the World Bank. With two digit inflation rates non-indexation would have solved the problem by condemning half of the pensioners to starvation. If this solution was to be avoided indexation was a must. And with falling real wages indexing to wages was *cheaper* than indexing to prices. Now that wages are likely to rise, either the Swiss indexation (the index is the average of the price and the wage indices) is introduced, as in Hungary, or pensions are indexed to prices as in Latvia.

Disdainful irresponsibility seems to have no limits. Commenting on the success of voluntary funds in the region a new analysis from an authoritative source declares:

> ...it would make sense if the East-Central European states went much further and replaced their PAYG, state-funded[8] systems with individualized investment accounts as was done in Chile in 1980... Over the long run, a switch to a Chilean-type system would have even greater payoffs, *allowing East-Central European governments to phase out most (and perhaps eventually all)* state pensions in favor of a viable, privately funded system (Kramer p. 86, emphasis added).

***Reform from above or from below?***

Authoritarian state socialism even in its 'soft' variant ignored the rules of democratic decision-making. It seems to me that these rules have not yet become 'second nature' of the new governments. The framework, the formal aspects of a parliamentary democracy are undoubtedly in place. The substance of democracy remains to be learned by all the partners, though. The detailed story above shows that when the Ministry of Finance took over the leadership of the reform, it

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[8] A common distortion or error. These public schemes are not state-, but contribution funded, exactly in the same way as the privatized pillar. In CEE countries the state's , that is the budget's statutory contribution does not exist (as e.g. in Austria).

became impervious to proposals, arguments or criticisms coming from any other agency. Financial interests and ideological convictions seem to have played a role larger than desirable.

The pension reform was undoubtedly a 'reform from above'. It is anybody's guess whether it could be anything else when the allotted time was cramped by the elections coming up in 1998. One may doubt though whether the haste was justified. The detailed calculations of the Directorate of the Pension Fund suggested that a less radical restructuring of the scheme would have been a cheaper remedy both on the short and on the longer run.

The democratic deficit is strengthening the apathy of people, their feeling that they don't count - that the 'res publica' is not really 'their thing'. This is a threat to the further development of democracy.

***Pension reform for what?***

*(Rhetoric and reality)* The rhetoric and the reality of the private pillar are at odds. The original 'psychological' aims -- increased autonomy, responsibility, and freedom of choice of the citizens -- have not materialized. For instance, the 'membership fee' of the insured is transferred to the chosen Fund in a mandatory way by the employer, without any particular responsibility or active participation of the insured person. Choice is restricted to a selection among the acknowledged funds. The aims of 'actuarial fairness' and 'market-conformity' have disappeared because of the compromises. People of my conviction may find reassuring the 'unisex' life expectancy; the state guarantees that make risk-taking a farce because people cannot get a lower pension than they would have gotten had they remained in the public pillar; or the strong state controls. But all this contrasts with the original ambitions of the financial lobby. As a matter of fact, one reason of the huge number of entrants is the state guarantee: the adherence to a private fund is a game in which the individual may win quite a lot, but lose only relatively little. The bulk of the losses will be covered by the general taxpayer.

* *(New 'patterns of integration?')* This is the most neglected aspect of the reform. As the ads of the Treasury suggest, the old values have become obsolete. The unwritten contract between generations, the solidaristic bonds between parents and children, or between any other more and less advantaged groups are seen as outdated. The weakening of the virtual social capital of the public funds, and of the collective structures which emerged under the former arrangements sap the integration of civil society in general.

The consequence of these changes is not only the further increase of income inequalities and poverty among the elderly because many will have to fall back on assistance. Another likely outcome is the withering away of the idea of equal citizenship, and of the idea that each person's human dignity has to be respected.

***Who pays the bill?***

* *(The missing contributions)* The claim that private pensions represent a smaller burden on the shoulders of the next generation is contestable. In fact, the contributions of the joiners are missing from the public tier. The Hungarian government calculated with around 300 thousand entrants in the first year, and a deficit of $90 million. In reality the PR campaign succeeded so well that in May 1998 there were already 800 thousand entrants, and the number may still grow. The estimated deficit in 1998 is at least USD 150 million (by and large 0,5% of the GDP) and certainly more in later years. This hole is filled by loans. Transition (February 1998) informed the public that the 'World Bank (is) to Support Hungary's Path Breaking Pension Reform.' For instance a $150 million public sector adjustment loan (PSAL) offered by the World has the specific aim to fill the budgetary deficit created by the pension reform (Figyelô 1998. 23 April:7).

Ironically enough, 'soft budgetary constraints' were long seen as enemy number one of a sound economy. Yet the vice state secretary of the Ministry of Finance declared recently that

> the shortfall of incomes from contributions will be covered by the budget. Moreover, there is no critical threshold in this instance. If there will be more entrants, the budget will cover the whole deficit without any fuss (Figyelô, 1998. 16 April:11).

The repaying of these debts (with interest) will weigh on the next generations who are supposed to be unburdened.

* *(Increased administration and control)* There are at least two elements increasing the costs. The administration of the huge public system (with a long routine and the advantages of economy of scale) amounted to about two per cent of the total outlays. The administrative costs of the private funds may absorb 10 to 25 per cent at the start, and cannot be much lower than 15 per cent even after maturation (see Simonovits inthis volume).

The other costly element is the intricate state apparatus required to support, to oversee, to monitor and if need be, to sanction the private pension market. The costs of setting up ad running a Supervisory Office, its Advisory Council, the Central Registering Office of the Funds, a Common Office of Income Collecting and a Guarantee Fund may be rather high. These costs -- similarly to the costs of the PR campaign -- have not been made public.

***Winners and losers***

The government's assertion that nobody would lose may be doubted.

The winners may be defined relatively easily. One of the positive changes in the public scheme is that the widow(er)s who are pensioners on their own rights will get 20 per cent of the pension of their deceased spouse. The young who will have a well-paid, stable jobs for decades may gain significantly provided the economic development will be smooth. The financial sector, among them the huge (Hungarian and foreign) private banks and insurance companies are likely to make important gains. Otherwise they would not have tried to find the loophole in the legislation that allowed them to create private pension funds in the first place[9]. Also they would not violently advertise and compete with each other, and would not try to entice (more crudely, bribe) either the potential joiners, or the financial administrators of the firms who may influence the workers. Whether the national economy will gain by the increased savings is a controversial issue much debated by international experts.

The losers and the losses are less easy to predict. The losses of the budget had been mentioned. They consist of the current loans required by the deficit in the public fund, and of the lost taxes due to the high tax break of the voluntary pension schemes. The distribution of the tax allowance amounting to about $150 million in 1998 is disproportionately favoring the better-off strata (Gál 1998. See on the general aspects Kvist and Sinfield, 1997). The burdens on the next generations because of the present new debts have already been mentioned.

The rules of the public fund have been changed in a way which is detrimental for the pensioners. The shortcomings of the former scheme (regressive scales, defective indexation of past wages) have not been remedied for those going on pension in the next 12 years. Their first pension will be lower by 10 to 20 per cent than it would have been in case of the reform proposed by the Pension Board. The Swiss indexation implies that if the real wages will increase -- an optimistic, but not unrealistic assumption -- the relative value of the pensions will gradually further erode. The loss will be greater in case of the cohorts under 47 years. For instance the replacement rate according to the current rules is, in the public system, 53 per cent after 20, 80 per cent after 40 years of service. These rates will decrease after 2013 to 33 and 66 per cent respectively for those who did not join the private tier. The reduction affects the joiners in at least the same way. Unfortunately the official PR materials never mention any of these problems.

There are also some other, less well calculable losses or uncertainties. The pension rights of those who are not fully disabled are in jeopardy as well as of those on early retirement. The funding of the public pensions has become more

[9] The Law (par 7, Act LXXXII 1997) foresaw mutual companies. Accordingly, it allowed the creation of compulsory pension funds for firms, professional associations or chambers, trade unions, the Pension Board, local self-governments, and voluntary pension funds, but *not for profit-oriented financial institutions*. Therefore the banks and insurance companies first set up a voluntary pension fund which was not prohibited by law. This lifted the legal obstacle. By now all major banks and insurance companies have created both funds.

uncertain because an amendment of an Act empowers the government to propose to the Parliament the reduction of the old-age benefits in case of budget difficulties.[10] The modification of the Law on the Pension Board weakening its legitimacy and curtailing its mandate does not help to defend the interests of the pensioners, either.

**Summing up: a preliminary assessment.**

A multi-dimensional assessment of the impact of the reform is difficult because many economic and social considerations affecting the future (mentioned for instance in Diamond et al., 1996) had not been discussed in the previous years. My account above may be biased but it is hard to deny that many of the problems mentioned are real.

There are competing assessments. From the perspective of the fiscal or monetarist lobby, the war is won, only some battles had been lost. From the perspective I share, an important war and many battles have been lost, but the losses would have been greater without the resistance of the Pension Board and of some actors of 'civil society', the independent experts among them.

The impact of the reform may be rather important, though. It seems that Hungary has become the model country of the region, highly praised by the international financial lobbies and agencies. The other countries are strongly encouraged to follow suite - a rather likely event in many of them including not only Poland, Croatia, and Slovenia, but also Russia (Rocha and Palacios 1996 p.37, Transition 1997, p.20). In this way Central-Eastern Europe may get farther from the models of the European Union than it used to be.

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[10] In 1996, the government unobtrusively included an amendment in the Act on the Reform of the Treasury (Act XXXVIII/92) that stipulates that if the deficit of any government fund, including the public Pension Fund would become 'too great', or may increase, the government may propose to the Parliament the reduction of the benefits.

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