

Fight between the Giant and the Dwarf - The Retirement Security Basics

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Abstract: The reform of the pension system is a cardinal and noteworthy subject in all countries of the European Union and it is often discussed in various scientific meetings. These economic and social challenges necessitate long-term government strategies, which need to be modelled, tested and verified. The following study describes the present pillars of the Hungarian pension system and goes into detail about the problems of the mandatory social insurance system, using demographic and statistic data. The main objective of this essay is to present a possible scenario of changes in the pension benefits in Hungary. It applies various statistics and a research based on a questionnaire on economical attitudes. This study consists of three parts. The first part shows the retirement security basics. The second part presents the pillars of the Hungarian pension system and the achievements of pension modelling. The third part summarizes the theoretical basics and results of the research project "The role of self-care in our lives".

Keywords: pension system, pension modelling, retirement security, self-care

1 The retirement security basics

Hungarian pension system is based on two main pillars: the mandatory social insurance system and the voluntary funds [1]. The modern mandatory social insurance system is burdened by three serious problems which threaten the financial balance of the Hungarian pension system in the long run [2]:

- the radical ageing of the population (people become older and older)
- the low level of employment (there are more who get assistance and less who pay contributions)
- partial payment of contributions (the state pension system operates at a loss)

The pay as you go system means that the state gets a certain pension contribution from employees every month which is distributed as benefits next month among the pensioners. The problem is that the capital reserve is not ensured for the

pensions to be distributed later, thus active employees only get a promise from the state to ensure their retirement benefit. Pension system experts realised as early as around 1990 that the pay as you go system was not sustainable for long with its existing conditions, the increase of the population would not be as considerable as it was after the second world war. They all predicted that birth rate would be set at a lower level, so fewer people would reach their earning years [3].

Besides the ageing of population there is the problem the low proportion of the actively employed population. Though the situation of the Hungarian job market generally improved in 2014, we still have to face various challenges. In the third quarter of 2014 full employment reached 62.8% (EU average being 65.5%), and unemployment rate was 7.4% among people 15-64 years old [4]. Improvement of the job market can be explained by the expansion of the public employment program and the increase of those having jobs in foreign countries. As far as long term employment and employment of young people is concerned, unemployment rate is still very high. Unemployment is a serious problem among women with young children and among the Roma community. During the last few years poverty has increased which indicates that the social safety cannot effectively decrease poverty. The social and educational systems do not really contribute to creating equal treatment and equal opportunities. The health care system, although it has gone through considerable transformation in the last few years, is faced with serious challenges. The health state of the population is rather poor and resources are not well exploited [5].

The first two tendencies require the increase of contribution rate, decrease of the proportion of pension/wages or the further increase of retirement age. The third tendency on the other hand needs making the pension system more attractive and making control stricter. The reasons of avoiding paying contributions are vaguely known and experts are carrying out researches to find them. The radical increase of the minimum wage requires the increase of contributions in certain segment of the shadow economy while in other segments there will be more unemployed and more people who do not pay contributions. Governments usually do not like to hear about this complex problem let alone openly discuss it [6] [7].

Hungary has the highest contributions for the minimum wages among all member countries of the Organisation for Economic Cooperation and Development (OECD) [8]. However minimum wages are not the highest in Hungary. The rate of state redistribution, especially tax centralisation exceeds by some percentage points the data of the neighbouring countries. To put it in other words, we have to pay more tax here in Hungary. An average Hungarian tax payer pays around 60% of his or her total income as a tax. 60% of all these high contributions are paid as welfare expenditure of which almost half is spent to pay pensions [9].

On the basis of charts 1, 2 and 3, it can be declared that the state will soon be unable to finance the rightful pensions of retired people from the contributions of active employed tax payers.

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(million)	2013	2050
Population	9,9	9,3
Active age (15-64)	6,75	5,426
Number of active	4,368	3,977
Number of elderly (65+)	1,5	2,3
Number of 55-64	1,2	1,1
Number of unemployed	0,2	0,2
Number of job holders	4,0	3,3

Chart 1.

Change in population with number of unemployed and active job holders

Source: EPC, 2015

On the basis of the model for the pay as you go system The 2015 report of the European Committee describes a pre-calculation [5]. This report suggests that considering Hungarian conditions in 2013 there will not be sufficient amount of pension in the future even if the general attitude to saving changes. It also concludes that elderly people will not have enough income thus we have to opt for a form of self provision in order to have a sufficient level of income when we retire.

(%)	2013	2050
Active age	58,2	58,1
Rate of actives	64,7	73,3
Dependence rate of elderly (65+ / 15-64)	25	48
Activity rate of 55-64	41,8	77,9
Unemployment	10,3	7,5
Employment rate	58,0	67,8

Chart 2.

Change in population with unemployment rate

Source: EPC, 2015

Pension systems should be improved so that they are suitable and sustainable throughout the European Union. In the last few years most of the member countries have transformed their pension systems due to the ageing of society. However as the recommendation report in 2014 suggests further reforms are needed to make pension systems more efficient and financially sustainable. The conformance of pension systems should also be preserved to supply proper income. Considering the trend of increasing life expectancy a more dynamic attitude has to be accepted to define the age of retirement. By systematically connecting mandatory retirement age to life expectancy there should be a balance between active and retirement years [5].

(GDP %)	Pension benefits		All benefits	
	2010	2050	2010	2050
Hungary	10,4	17,1	21,2	28,8
EU-27	10,6	12,8	23,4	27

Chart 3.
Changes in pension benefits

Source: EPC, 2015

2 The basics of self-care

OECD countries which Hungary joined in 1996 have as their main objective to help the governments of member countries create the best economical and social policies possible [8] [9]. Figure 1 depicts the main frame of different pension systems. As already mentioned Hungarian pension system has two main pillars, the mandatory social insurance system (giant) and the voluntary funds (dwarf). Among the 30 OECD member countries only Hungary, New-Zealand and Ireland do not have mandatory second pillar based on community and private systems [1]. Figure 2 depicts pension systems based on three pillars [8] [9]. The nationalization of private voluntary pension funds was highly debated, although it contributed to the stabilization of the pension system in Hungary.

Experts have different opinions about the effects of nationalization. Some say that at least the state could stabilize incomes and but others have completely different opinion. Those who criticise this measurement admit that private pension funds can go bankrupt any time, so as many as 40 years of active employment may produce no pension at all. On the other hand the state can in any case create financial security for pensions, even by means of political power [2]. According to demographic forecasts Hungarian population will not reach 9 million by the year 2060. It is really interesting to observe the tendencies of the population of 50 and 80 years in the following years. Due to the ever increasing life expectancy the proportion of people of 50 years and of people of 80 years will be equal. Because of decrease in birth the proportion of the active and „productive” segment of the population is becoming less and less every year, thus the financial support of the quickly growing elderly generation will be soon endangered [10]. This process will change the social and economical nature of the country which brings up serious challenges. As figure 3 shows the population of the whole European Union follows the same tendencies and the age pyramid is very similar to that of Hungary.

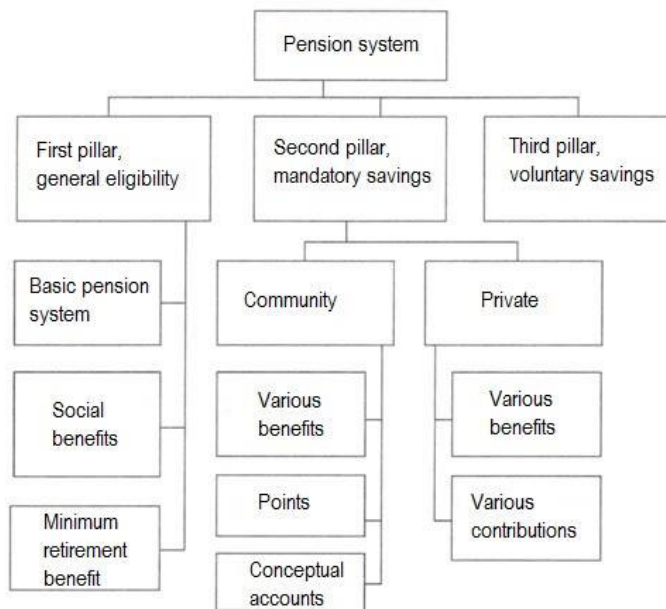


Figure 1

Summary of the various kinds of retirement benefit systems [1]

The previously described data prove that there is a growing need of self provision as we can only count on our own savings in our elderly years. The only difference between voluntary pension funds and private pension funds is that in private funds the amount of contribution paid by individuals are not set by the individuals themselves but by the law.

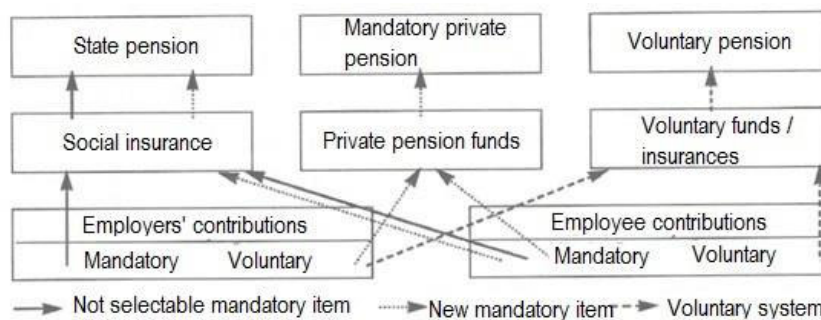


Figure 2

Pension system with 3 pillars [11]

There are two important data to be compared: average wage and average pension. On the basis of this difference it can be predicted whether we our pension benefit is going to ensure an acceptable living standard.

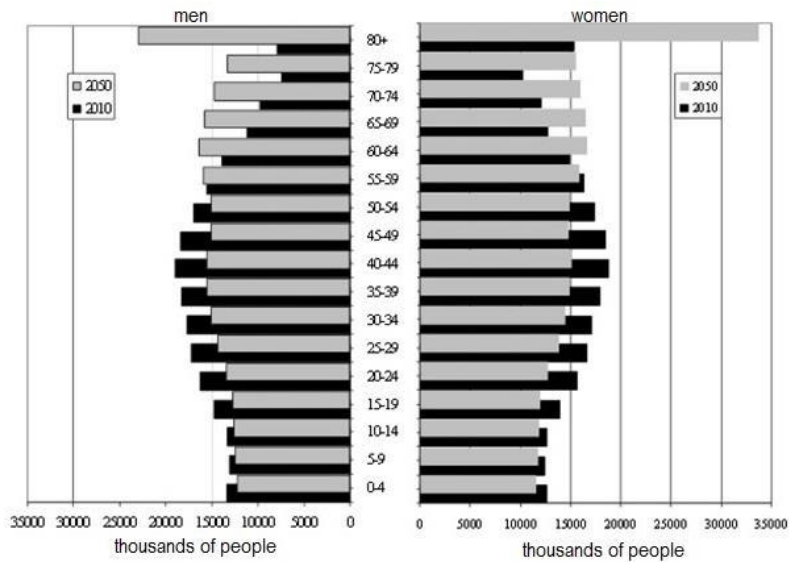


Figure 3

Age pyramid of total population of EU27, 2010-2050 [12]

Figure 4 show these tendencies in Hungary. Numbers are going to increase but there will always be a difference in the future, which means that average wage will be higher than average pension.

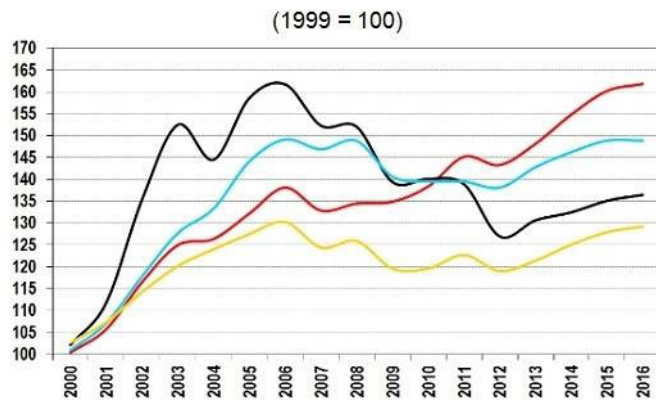


Figure 4

Average pension (blue), average wage private sector (red), average wage public sector (black), real income (yellow) (between 2000-2016) [10]

3 “The role of self-care in our lives” questionnaire

In highly developed European countries self provision has been emphasized for a long time [3]. Self provision helps us to keep our personal independence and it shows our responsible attitude towards our family [2]. Chart 4 depicts the summary of questionnaires of the Óbuda University, Keleti Faculty of Business and Management in 2015 and 2016. Questionnaires could be filled in online (<http://www.kerdoivem.hu/kerdoiv/797589352/>) or on paper. There were 222 questionnaires filled in altogether.

My questions were related to pension systems, pension savings systems, self-care and planning retirement security, as these elements define the financial backgrounds of one’s future existence, that is, the extent of self-care (see Chart 4). The questions were grouped into three categories:

- The role of self-care (savings);
- Pension systems (compulsory, voluntary);
- Financial planning (seeking expert financial advice).

The qualitative research analyses the three groups separately. In order to understand the motivations behind our decisions [13] more deeply, I used certain parts of factor analysis, which is a popular computer method nowadays [14] [15]. I used the SPSS software and help from the department to process the questionnaires and perform the statistical calculations [16] [17]. Different statistical analyses were performed on the three groups, such as averages, frequency, cross tabulation analysis [17].

Basic questions were about retirement savings and planning as these can determine the financial background of our future existence and our self provision. On the basis of answers to questions 3 and 4 of chart 4 it can be said that young people are generally well informed about the pension system, however they do not think it is important to plan their financial situation for the long term, which is proved by the answers given for question 5. For question 4, 16.16% of young people chose „Other”, which means they vote for an alternative form of financial planning. „Other” means voluntary pension funds, supplementary funds, pension savings bank account, pension insurance, special life insurance, investment life insurance, purchase of gold or real estate as a form of investment.

Choice of alternatives is abundant in spite of the small number of answers. Young people think they have several options to make a foundation for their future financial situation. Naturally state pension system is mandatory, however as far as voluntary and private funds are concerned our decisions are usually made according to our income and our emotional decisions.

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Questions	Answers	Percentage
1. Gender		
Male	138	62,2%
Female	84	37,8%
2. Age		
below 28	118	53,2%
between 29-48	86	38,7%
above 48	18	8,1%
3. The role of self-care		
Yes	126	56,8%
No	96	43,2%
4. Knowledge about the pension system		
State pension		
Yes	82	36,9%
No	144	63,1%
Private pension		
Yes	60	27%
No	162	73%
Other possibilities		
Yes	62	16,16%
No	160	83,84%
5. Financial planning		
Yes	64	28,8%
No	158	71,2%
Total number of respondents	222	100%

Chart 4.
“The role of self-care in our lives” questionnaire

Source: my own research, 2015 (N=222)

Conclusions

The actual pay as you go pension system is still quite popular although it has to face a serious crisis, so probably it will continue in some form or another. Experts opt for the mixed pension system but there is still no model everyone would accept as ideal. According to predictions the proportion of active tax payers and pensioners will drastically change. The problem of sustainability highly determines the possible models. The sustainability of the pension system is determined by the proportion of the employees, that is tax payers and pensioners, because pensioners receive their retirement benefit from the contributions of the active job holders. The two sides should be balanced from the point of view of macro economy. Some professional meeting and discussion are needed to try to solve the problem of retirement benefits irrespectively of politics or economical position. Research is mainly done at universities even in more developed countries while the state only plays a supportive role, as decision makers do not have time to work on new methods. Naturally the problems of the pension systems that various experts and government could not solve are not expected to be cleared up a simple essay. However it should be stated that there are possibilities to forecast the various effects of the retirement pension systems.

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