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# *Pension System in the Changing Society*

**SUMMARY:** In the past three decades, several attempts in various directions have been initiated for reforming the pension system. The reforms are needed to ensure financial viability on the one hand, and to achieve greater justice, on the other hand. Parametric reforms are not enough. A paradigm shift is needed in the pension system! To that end, the insurance paradigm in the state pension system must be replaced with an investment paradigm, and, to be more specific, to the paradigm of investing into human capital. We don't save for our older selves, we repay our predecessors what they invested in us. Our work pensions would be complemented by the second channel payable based on children or based on the voluntary pension fund. The latter should be chosen by those who do not or could not have children. If they do, eventually, have children, they can change to the children-based pension channel. The proposed reform would result in greater justice at all events. It would, however, be a viable step. It could have a significant role in strengthening family solidarity, encouraging having children and the mitigation of demographic problems.

**KEYWORDS:** pension reform, costs of having children, children-based pension, voluntary pension fund savings

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The pension system established in the Socialist era, which was built on state care for forty years instead of the former insurance principle, was overthrown by the increasing individualism around 1990 and the period following it. The system tried to return to some form of insurance basis. At the same time, social conditions went through a fundamental change compared to previous eras. The size of hidden state debt existing in the form of pension commitments was becoming more and more threatening. The pension reform seemed unavoidable in the long run, for financing reasons alone. The equilibrium of the system could only be

maintained with a high level of social security contributions. The reform-communist elite was already contemplating the capitalization of the social security (SS) system before 1990 so that it could fulfil its future obligations.

## POST 1990

Unfortunately, capitalization did not take place during the later privatization.

The sizable absence of the pension system in the '90s (and, therefore, the necessity of a reform) was, in a large part, the result of the fact that the totality of pension expenditures was increased by early retirements and (formal) declarations of disability, as a major proportion

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of the mass unemployment was 'solved' this way during the Antall-government.

The head of the Hungarian social security system appointed upon the regime change talked about the need for a substantial reform (one that would take into consideration the children raised) at a social committee hearing in the Parliament in 1991-1992. His proposal was based on the idea that this cost should also be recognized when determining pensions. According to his proposal, the allowance should be somehow connected to certain levels of education provided to the children. The pension reform proposal received vehement opposition. The reform took a completely different direction.

One of the reform proposals wanted to redeem state care with small grassroot communities following the example set by the French '*mutualité*', i.e. voluntary insurance funds. The act on voluntary pension funds was adopted in 1993, for the purpose of additional insurance. In 1993, the social security system was divided into two, and the local governments of pension and health insurance funds were established. Such local governments, however, did not brought about notable improvements in financial management – quite the contrary. The costs doubled.

The approach towards the pension reform further changed in the second cycle following the regime change (1994-1998). In line with the recommendations of international financial organisations, the new government aimed to establish the second pillar: the funded scheme. (The same as in other Central-European countries, including, amongst others, Poland.) This meant a partial return to the funded scheme paradigm, with, however, the division of contributions. This step was subsequently criticised by several experts (Bartha, Tóth, 2013). As far as we are concerned: we have always opposed it. According to *József Botos*, the transition to the funded scheme does

not constitute a major reform, it is only a financial engineering maneuver (Botos, 1998.) Therefore, in Hungarian literature, independently from international literature, simply based on the Hungarian statistical figures, the need for taking children into account in the pension system was already clearly formulated more than twenty years ago (Botos, 1998; pp. 47-48).

The government of the second cycle, however, did not rely on this approach at all. In 1998, the sources withdrawn or 'redirected' from the existing system became the basis of the second pillar in the mandatory private pension fund system. These sources had to be compensated. This resulted a deficit in the government budget, which had to support the state social security system. The founding fathers of the reform, *Péter Mihályi* and *Csaba László* hoped that the deficit would somehow be evened out from other sources in the budgets. They also acknowledged the futility of this later on themselves. As they put it: '*Looking back from today, this was a reasonable yet bad compromise*' (Mihályi, 2018).

Therefore, a part of the needs for financing was caused by the reform itself. The funds, as we have already mentioned before, were operating a lot more expensively than the state system. (While between 1990 and 1993, the operating cost of the unified social security system was 1.5%, that of private pension funds amounted to 6-7% later on. Practically, they took a substantial part of payments for their own costs and managers' salaries. Based on the scheme, the first group of retiring people received not more, but even less pension after 10 years compared to the scenario if they stayed in the state system.)

The matter of further developing the pension system remained on the agenda. The issue was analysed by the so-called Pension and Old-age Roundtable established by the government. (Holtzer ed., 2010) In his study

published in the summary volume, pension expert *Rudolf Borlói* pointed out that based on international experience, the most reasonable pension system is the point system existing in Germany. However, a major part of Hungarian opinions saw the long-term solution in the continued liberalisation of the mandatory pension fund regulation, and voted for this option.

In October, 2010, the authors of this study once again stated their position of the need to return to the state pension system: to a reformed, point system-based version (Botos J., Botos K., 2010). (Rudolf Borlói also made a similar statement later on in 2016.) In any case, based on the decision of the government the second pillar ceased as of January 1, 2012. The majority of contribution-payers were returned to the so-called state pension system. (This phenomenon is far from being a Hungarian particularity. After the financial crisis, a similar process took place even in Chile, which was considered a model country.)

The assets piled up in funds were taken by the state and the majority was used for debt repayment. The communication of this step, however, was not sufficiently elaborated. Many people complained, not understanding that the money was never really theirs: although the reform made them owners in the funded pillar, the state forgot to add that the citizens are indebted to the previous generation with the sums withdrawn from the state system. But neither they, nor the previous legislators considered the payment of contributions what it truly is: repayment to the generation of the parents.

Amongst the changes introduced by the governments after 2010, the one that had the largest impact was the introduction of 65 year retirement age. Although this was effective as of January 2010 (with gradual introduction), the relevant decision was made back on May

11, 2009 (i.e. during the reign of the so-called expert government). Later on, large-scale reforms were implemented 'under the table' by the post-2010 governments. Although the society experienced the parametric changes (restrictions), it failed to notice the point: the relative independence of the social security system within public finances came to an end in Hungary. They made the contributions paid by companies tax-like (social contribution tax), for which no service can be expected. It is specified by the act on social security (adopted with simple majority) as may be in effect from time to time, and it is financed by the sources firmly integrated into the state budget. (Changing the pension act is possible and depends on the governments.) The reform of the administrative apparatus meant further concentration, which meant that the former separated social security funds were terminated. The insurance quality is now only reflected in certain calculation methods and in the years of service taken into consideration.

The implemented parametric reforms, including the extension of service time, the strong limitation of the generosity of the system, the termination of Swiss indexation and making it exclusively inflation-targeting (as the extent of inflation is low), had a positive effect on the equilibrium of the pension system. A fair system also sustainable in the long run, however, has not been established. On the contrary, the tensions existing in the pension system further increased between the new and former pensions, especially on account of the unavoidable catching up of salaries.

It must be seen, however, that the reform of the pension system is not only a matter of finances. It can be traced back to much deeper socio-structural changes – in practice, to the crisis of the basic unit of the society: the family (Botos K., 2016). No one has addressed this in relation to the reforms.

## THE BASIS OF THE REFORM

The problems regarding the pension system and demographics has been presented by many in various forms, both in Hungarian and international literature (Cseh-Szombathy, Tóth, 2001). We are not even going to attempt to review all these presentations. We would just like to focus on some simple links here.

The present pension system is not fair. It expressly punishes families that raise children. The pension of those having children is probably more unfavourable than that of those not having any children. The provision of high level replacement rate for elderly age, however odd it may sound, is one of the negative incentives of the system, in terms of having children. Having children is not indispensable to ensure that one can get by even at their old ages.

To that end, József Botos and several other authors also proposed the necessity of a reform that takes into account children in the past decades (Botos J. 1998; Mészáros J., Banyár J., 2004; Schlett A. 2009, 2011; Botos J., Botos K., 2011; Botos K., 2009, 2011, 2012; Szegő, Giday 2012; Banyár, Gál, Mészáros, 2016; Demény P. 2016; It should be noted that Pál Demény represented this idea in foreign literature before anyone else). According to these ideas, one of the aspects of the reform is indeed to make the pension system influence the rate of bearing children, and thus, to influence family and generational solidarity, either directly or indirectly. The society must accept that having children is not an individual hobby, but a matter of public interest. The children are needed by the childless, too! And raising the children is just as necessary for the operation of the entirety of the pension system, as the payment of contributions pro-rated to wages.

Let's take a closer look: why exactly is the reform of the pension system indispensable?

## Why is the pension system reform indispensable?

A person, if he works all his active life and takes care of his children in the meantime, practically only pays a few years' extra in the form of contribution pro-rated to wages into the budget, which is used to cover his parents' pension. In principle, this surplus could serve as the 'coverage' of his own pension. The person, however, lives significantly longer as a pensioner than these few years! Fortunately, his children at working age start working themselves during the baseline 40 years, so they pay contributions, too. This is what covers the pension now payable to their parents. (And not the pension payable to themselves, as suggested by the insurance approach.) The contribution payment of consecutive generations ensure the allowances paid to the pensioners. At a macro level, from the point of society, only having children is the basis of pension! So far, the government does not feel a strong urge to make a paradigmatic change. The relatively high replacement rate (ratio of pension/wage) existing in today's pension system can also be sustained, which amounts to 80% after 40 years of service, but the true average is hardly 60%. The experts of the Hungarian National Bank take the view that the pension system is balanced until 2035 (Freudenberg, Berki, Reich, 2016). According to their calculations, there will be no problems with financing pensions until 2035. Up to this point, maximum the prolongation of life expectancy plays a role in the increase of the financing need. The change in fertility, even if it is a positive one, is not a factor, as its impacts can only be felt after approx. two decades. It must be seen, however, that the dramatic impact will be felt in the long run! The equilibrium could only be maintained from a demographic point of view if citizens were to have children in their twenties. Otherwise,

if the date of having children and getting married is deferred and the parents have much less than two children in average, the withdrawable income sufficient for covering the allowance payable to the elderly (living longer and longer) during their pensioner age will not be generated. This way, a deficit is generated in the system. The contribution-paying generations fall out! The rate of fertility and the number of children born remain below the value necessary for reproduction! Based on current statistical figures, and looking way ahead in the future, this is the situation that can be expected. Although the fertility rate improved a bit in the past years, it is still only at maximum 1.5. On top of that, the date of having children is postponed to people's early thirties. (Although the government has set an ambitious goal: to reach the number of births necessary for the reproduction of the population by 2030. However, we saw it that it could only be expected much later, in the decades after 2035.) Practically, the impact of the postponement of having children cannot be compensated from the perspective of contribution payment. The state, if it wants to fulfil its current pension commitments, has to find another source to provide social support to low-income elderly people, and must supplement the allowance from other state revenues.

There are some amongst the supporters of the children-based pension system who formulate their thoughts sharply and say that the current pension system lies: it claims that you are entitled to pension because you pay the contribution. However, the source of pension is only created by the children raised, so only they should be entitled to receive it (Banyár, 2019). As to the other: save up.... We can agree with this thought in some sense. At the same time, we contemplate a *two-channel solution*, for several reasons.

The level of pensions is expected to be low

not only due to demography, but also as a result of the change of net wages. In the case of certain generations, it is only expected to reach 30-40% of average salaries. Many people were employed officially for minimum wage. Also many people have chosen special taxation. There are more and more people who have worked their 40 years with such low taxation. *'No matter how much KATA you pay, you won't have a palpable pension. So be happy for the low fee of KATA, but reserve what you save on it for your older days'* – wrote *András Farkas* in his consulting blog (Farkas, 2017). Pension savings will be a vital issue for many!

People's apathy towards their future is almost incomprehensible. They solely rely on 'making it somehow.' The state will do something eventually. They could only ensure their future in two ways: with savings, i.e. for example by paying contribution and the pension fund payments complementing the same, and by having and raising children. They, however, do not care for this much. Yet, the expenditures that must be made for the future today, such as the expenditures spent on children or savings, cannot be escaped by any means. Choosing the burdens coming with a family is not an option, but a necessity! This is what society should realise. To that end, government measures should aim to make family solidarity necessary and feasible and the same time.

However, we cannot agree with initiatives urging us to transition (or return) to the social security system that is based exclusively on family solidarity. (This is what the social reality before the establishment of the social security system was like, that is when elderly people were maintained by their children. It would be quite similar if parents only received pension after their children.) But what would happen with those who do not or could not have children involuntarily? Not every childlessness is voluntary. Another problem

that is added to having children is that finding one's partner became much more difficult in atomized societies. For those who want to have children, too. People's willingness to commit has weakened a lot. On top of it all, infertility became an epidemic in the past decades. Owing to the options of birth control, few children are born even in the existing relationships. Naturally, these deeper reasons also require analysis and solution.

There is also a possibility for the case of childlessness: savings. This is what the savings scheme built exclusively and expressly on the principle of capitalisation is based on. We will cover this in detail later on.

In the old days, children were born partly because there was nothing people could do to prevent it, and partly because descendants were needed for the family to get by. However, the conditions in society have gone through a fundamental change in the past century. Parents practically have no direct 'profit' from the children as labour force. Neither by using the work of the offspring in their own activity, nor by using their help in their old age. As a matter of fact, many times it is not even possible for the different generations to live in a community, in close physical proximity to each other. Urbanisation brings many young people away from their hometowns.

Therefore, it is reasonable to rely on the notion that the state social security system should be maintained on the basis of solidarity. Every citizen should be able to get (work)pension! They should strive to achieve it and it should be possible for them to do so! This means that we think that people should continue to acquire their elderly age pension entitlement individually with their payments made in their active years. This entitlement, however, is not based on the funding of their payments! The system is not covered by material (financial) means! (We implied that the amounts coming in are 'going out' or

flowing out instantly from the state budget, in the form of allowance granted to the elderly.) If a part of the salaries paid (payment of contribution, social contribution) could not be ripped out from the income generated by employees, the coverage for the subsistence of the previous generation would not be ensured! Therefore, pension depends on the children born for the entire society! However, the rate of having children decreased in the past decades. It is clear that the birth of children depends on the parents' intentions, and this intention is influenced by many factors, including finances, comfortability and social status. Therefore, it is important for the pension system to have a positive, strengthening influence on the willingness to have children. Practically every state pension insurance system is only viable if there is a sufficient number of children born in due time per each pair of parents. (It is important to highlight the expression 'born in due time'!) This means that the system is, in fact, based on human capital coverage.

At the same time, it is necessary to make active generations interested in making income. To that end, everyone should link their own pension expectations to their own work earnings, or, to be more accurate, to the payments made from such earnings. However, the sustainability of the system undoubtedly depends on whether the next active working generation of similar number will be born and raised. It depends on whether there will be a sufficient number of employable individuals in the next generation who can utilise their human capital for generating income. This is not ensured by payment of contributions in itself. It only entitles people to acquire a work pension, which, however, apparently will only provide a quite meager living conditions for citizens under the current regulation. This means that it is quite probable that the work pension will not cover one's subsistence. As a result of the visible change in demographics,

the pension commitments corresponding to the current rate could only be provided with a substantial increase of contributions. However, the Hungarian government constantly tries to reduce the burdens of labour. Indeed, it would not be proper to place heavy burdens on the shoulder of the active generation. The international competition would not allow it, either. Work pension must be complemented by having children or by savings by all means.

This revelation is still not part of public perception. On the contrary! Many people believe that those having children 'get enough support already.'

The current supports concentrate on the mitigation of burdens. Families use a substantial part of their budget to raise their children, almost as a 'second contribution payment.' (This is why many people do not have children in part: a family having two children and working for average salaries will find themselves below the poverty threshold before they know it if they have the two children necessary for social reproduction.) People are instinctively good economists: their decisions are influenced by the sensible disadvantage. *Balázs Reizer* presented that according to his studies, the earning per person in families having children decreased with almost 20% *ceteris paribus* as a result of having children, which means an approximately 12 unit fallback on an income scale of 100 for the households having their first children, and a fallback of 8 units in the households with other children (Reizer, 2011).

In the case of women, another issue to tackle regarding the matter of pension (which is, by the way, a positive trait of family support): the longer periods spent on maternity leave (receiving child home care allowance (GYES) or child care fee (GYED)). *János Köllői* revealed it a decade ago (Köllői, 2008) that the Hungarian child support system was urging women with small children for a longer period

to exit the labour market for the long term. Today, child care is calculated into the years of entitlement, yet, fall out from the labour market has some disadvantages. The insurance approach of the pension system remunerates this in an expressly unfavourable manner: the virtual allowance base will most probably be less than that generated in the case of workers, as their wage is increased during such a long time presumably. If, therefore, mothers could only expect income at their old age counting on their work pension, they are sure to receive a more unfavourable pension than childless people, even with the same number of active years.

The work carried out in the family is not regarded as actual work by the members of the society. Yet, many researches conducted by TÁRKI outline that the need of children raised in the family for labour force reaches statutory working hours. This way, stay-at-home mothers (most of the time, they are mothers, but this can also be interpreted for the other sex), as put by *Zsuzsa Morvay*, should be regarded 'incapable of work' the same way as if they had to stay at home for other reasons (Morvay, 2019). While, if someone is incapable of work in the Hungarian society, they are entitled to sickness benefits and pension. In both forms of care, they receive a much bigger rate of their salaries than the amount of child care support. While, her work performed at home is of utmost importance and use for the society!

If a child goes into bad ways as a result of education at home, according to calculations, a single police measure costs the same amount as financing an entire year of a skilled worker student. We are not trying to say, of course, that the children of working parents go into bad ways in all cases. It is safe to state, however, that children welcomed with a hot meal at home, whom their parents ask about their day, whose social relationships are

supervised by the parents, whose parents help in their studies – or at least supervise it –, and whose parents maybe also contributes in spending their free time in a useful manner are socialising differently than those who are not supported by their parents like this. Moreover, maintaining the institution system serving the day-time care of children also has severe costs. These institutions are overcrowded in the majority of the cases and their capacities are not sufficient (although their development is intended today). Many times, this as an additional reason why mothers cannot find a job (Blaskó et al., 2009). (Although the sources referenced are almost 10 years old, similar phenomena can still be observed in the current situation.)

Obviously, it is not easy to quickly increase the amounts of family support in a more significant manner compared to the previous increases. It is a known fact that the generosity of Hungarian family support is also outstanding on a European level. (Although when they say this, they do not add that the Hungarian wages are extremely low compared to those in Western countries, even today, although some significant wage improvements took place in the past one or two years. Thus, if two incomes are needed for the family to get by, the higher rate child support and giving income to those raising children is justified, as one party falls out from the labour market.) The impact of financial support is not always reflected by the change of demographic processes distinctly. [Although surveys say that their withdrawal can be felt quite distinctly, it has a negative impact on the willingness of middle-class families to have children (Spéder, 2017)].

We believe, therefore, that the family costs spent on children should be conceived as a second form of contribution payment! Thus, the solution could be the introduction of a two-channel pension system.

### The solution could be the introduction of a two-channel pension system

If 'remunerating' having children is realised in the pension system in line with our proposal, the cost implications of this will appear in a delayed manner in the state budget. It is not a concern that we would place excessive burdens on the central budget in this period. If, however, the operation of the system brings about the contemplated effect, and it is accompanied by higher rates of child birth (and education), then this could create the basis necessary for covering the extra costs in the long run, exactly through the fact that the children raised will pay taxes and contributions in their working age. If these children are not born, there would not be tax and contribution payers in due number and in due time when the contribution must be paid for the benefit of the parents. This is why we claim that the two-channel pension system would be a step resulting in complex positive impacts by all means. It would promote social justice better than the current one, and it would have favourable impacts on both financial sustainability and population policy. This reform is necessary and possible, and, therefore, it is feasible!

It is incomprehensible how it did not have a breakthrough on the level of politics! Especially because the Hungarian government reigning since 2010 has put a great emphasis on the family issue. We can only attribute this hesitation to the medium-term conceptual horizon of politics.

The introduction of the two-channel pension system could be the answer for the proposals that have been supporting the introduction of the so-called '*unconditional base income*' nowadays.<sup>1</sup> What does this have to do with the pension reform? If developed countries consider guaranteeing a minimum livelihood in society justified, then it should

not be given without any conditions, but should be subjected to activities or activity that benefits the society. Although this is a condition in some sense, it is a quite legitimate one from the point of the subsistence of the society. There is hardly any activity more useful than having and raising children. But we must highlight: in the pension system, they would only be entitled to the benefit payable for the children if they did indeed provide education to their children at least to the level of minimum average literacy (which means the acquisition of a profession or high school qualification today).

## THE ISSUES OF THE CHILDREN-BASED PENSION CHANNEL

The proposed pension reform may be attacked exactly from the point of its conditionality. It may also be criticised owing to the fact that it considers the family as the basic unit of society instead of the individual. It would, indeed, be tied to families (at least to parent pairs). It would not, however, mean unconditional support, as it would be granted only if the required education has been provided to the children. At the same time, we suggest that it is worth fighting the counter-opinions of the proposal owing to its multidirectional positive impact.

First of all, the fact that it would bring a sustainable scheme is an unconditional positive element of our proposal. Financial expenditures that are not unconditional, and, so, are subject to certain conditions, give incentive to the members of the society to find a permanent solution for the problem, exactly as a result of its conditions. The system that ties the pension of families to the education of children will result in a more qualified generation on a social scale. Naturally, all this would only increase willingness to have

children in an indirect manner. But if the 'return' of the sacrifice related to having children is reflected in pension, it would, presumably, increase willingness to have children slowly, and it would nonetheless promote the education of children.

For the flexible adaptation necessary in modern economy, one must have a versatile qualification. The pension system would not only remunerate having children, but also educating them, as the urge to have children in itself does not guarantee a generation in society that will be able to hold their own on the labour market. Therefore, it is a substantial element of the proposal that it differentiates according to the level of qualification the parent pairs can provide to their children. This is fair. Undoubtedly, providing further education to children in excess of vocational training or secondary education means significant costs for the family. (Outstanding American economists Rajan, Reich and Stiglitz prove that in the USA, young people with high income can owe their income to the fact that their parents ensured that they could go to the best schools possible.)

This cost-based approach has the obvious disadvantage that not every training or education means expenditures that are truly necessary on the labour market. Many people obtain tertiary qualifications and end up working on different areas. If they do not find a job on the field of their qualifications, their general literacy will allow them to quickly adapt to other fields. According to previous experience, the job finding rates of human sciences students are not at all worse than those of intellectuals with other specialisations.

This development could make the pension system sustainable in the long term. Step by step, it would become clear for the members of the society that taking some sacrifices in the present may be worth for ensuring a more safer income at their old age. If the number

of children increases, and they are raised through education, the investment made in human capital will pay for everyone: both for the society (in tax and contribution payment) and for individuals, in the more favourable pension possibilities of people having children.

It is not sure that the educated child will make use of his skills in Hungary. This is, in fact, another serious problem. In the past decades, the EU's free movement of workers policy only resulted in Western Europe taking up all the labour force from the eastern areas. Hungary is not even in the worst situation. The Baltic states, Poland, Romania and Bulgaria 'produced' even worse figures than Hungarian emigration. This subject poses the question of fairness – on an EU level. Emigration and working abroad cannot be approached only from the perspective of the individual. It is not enough either if we also take into consideration the positive effect caused by incomes potentially sent back home. These foreign currency amounts do, in fact, contribute to the improvement of the balance of payments in Hungary on a macroeconomic level, but they do not mean sources for the budget. Yet, a significant part of the costs of their training and education was financed by that budget. In Hungary, and generally across Europe, a substantial part of education, health care and social subsidies are financed from taxes and contributions. Their reimbursement by the rising generation to the budget and the community is a legitimate expectation. Our tax and contribution payment obligations can also be viewed in this manner. If, however, someone pays public dues in his foreign work place, he contributes to the public finances of the host country. He/she, as an individual, will not suffer any disadvantages arising from this, as he uses the country's infrastructure and he will receive his pension from that country

pro-rated to the work he has done there. The country, however, where he was raised and educated, will suffer the impacts of the payments missing from the large systems.

Different principles prevail across the EU at the moment, with the individualist insurance approach being the most dominant one. '*I save for myself*', so it does not matter where, in which country and with what kind of work I collect my pension elements. What I have worked in another country, I will receive from there. This approach is completely appropriate for those interested in mobility. At the same time, it is in opposition with the reform we propose in the pension system. Social reproduction based on families starts from the premise that with their contribution payment, the active generation of parents is, on the one hand, 'repaying' the 'human capital investments' invested in them by the grandparents. Therefore, citizens invest in their children, and as the state of the specific country also contributes to this investment from public funds, return should also be examined on the level of the country.

Without making this investment approach general in theory, it will not be easy to establish a coordinated practice in the EU. Naturally, the coordination of this system with the basically individualist pension insurance system of other countries means a difficult diplomatic task. This difficulty, however, cannot be an obstacle for Hungary to introduce a family-based system, serving the persistence of the country's population.

Moreover, anyone would be right to say that the family-based pension system does not acknowledge the fact the family in its traditional sense is on the verge of disappearing all across Europe. The disruption of marriages and relationships is, indeed, a problem that we must face (as we have already suggested this before). It is a fact that a quite significant part of children (almost half of them) are born

out of wedlock today, even in Hungary. The institution of marriage is often replaced with domestic partnership. Can a system based on the costs of having and educating children be interpreted amongst these conditions?

The first question to ask is whether this phenomenon (even if it is a fact) is good for society. Above all: is it good for the children themselves? Of course, it is not (Fagan, 2012). Should the elimination of marriages, or at least, the reduction of their number be regarded as a trend that is an irreversible legality? It may serve as an encouragement that according to recently published data, after long periods of continuous decline, the number of marriages started to grow in Hungary once again. This means that marriage is not necessarily an institution that is 'going extinct.' We should not, therefore, start from the premise that the tendencies of processes in the society cannot change due to some fatalism. It is certain that it is necessary to realise for a positive change that the mass disruption of marriages have a negative effect on both the individual life of the children to be born as well as on the future of the society. Therefore, the institutional changes that promote the stabilisation of marriages are useful. (This topic goes far beyond the subject of this study, i.e. the organisation of the pension system.)

The problems related to demographic developments, even if they complicate the situation, are not unresolvable from the point of the pension reform proposal. It does not force the keeping together of bad marriages. If the divorced person fulfils his or her fair obligation to pay child support, then the amount spent on the child can be taken into consideration in his or her case, too. It is true, however, that the 'unpaid work' done in the household is not taken into account amongst the 'sacrifice elements' of child care (it cannot necessarily be taken into account either in the case of 'child points' accurately). The effective

expenditures meaning the average costs of raising a child, however, can be specified accurately. Based on the foregoing, therefore, divorced parents who pay child support properly could also get 'scores' in the system proposed by us.

Another expected objection against the proposal is that it is unfavourable for the childless. This, however, is simply not true! It can be warded off with a relatively simple explanation, as it is obvious that one who does not have children does not spend on them either. In opposition to his fellow citizen who has children, he can save this amount in order to ensure the safety of his elderly days, and, in fact, he must save it! This way, the pension system could be based on two channels in all cases. Paying contribution out of our monetary income is only one of the channels. The other channel is the ratio of income spent on children. If I do not have to spend on them, I can save it. This is the second channel for the childless. The society must reach a level of awareness where people think about their future safety from the earliest days of their working age, in excess of their pension received after their work. This system, or, to be more accurate, the further development of saving schemes with pension purposes must be implemented as soon as possible.

We can say, with the criticism coming from the other side, that this solution makes being childless an easy choice. Yet, the birth of unwanted children is by no means an aim of this proposal. The system does not coerce people to have unwanted children. This would be the worst for the children themselves. However, the reform would benefit anyone who wants to have children in comparison to today's (unjust) system. Our proposal is expressly aimed at making the decision to have children easier for those who want to have children. At the same time, there should be a solution for the childless, too.

## REVIEW OF VOLUNTARY SAVING SCHEMES

*Anett Pandurits* gives an excellent review on the existing schemes of pension savings in Hungary (Pandurits, 2017). She shows that almost every savings arrangement enjoys some form of state subsidy. Not only in Hungary, but in other countries in the world, too.

Savings arrangements should undergo a comprehensive review, primarily from the perspective that the state should only support the long-term schemes that are aimed at pension savings. (The remaining savings arrangements are based on personal considerations and primarily serve the interest of the financial sector. The necessity of savings has been presumably made clear to the population by the past thirty years of the market economy.) As it could be read in the referenced publication of the insurance expert, the Hungarian pension fund scheme is a special combination of the open institutions known in the West and the closed ones. In Hungary, general social care prevails. (In the current pension fund saving schemes, it is possible to use the amounts for purposes other than pension.) In the case of the categorisation and review of savings plans, it should be achieved that instead of being directed by the lobby interest of the sector, it should be carried out by independent persons with, as the Anglo-Saxon put it, academic-university or research background. For this, sources independent from the financial sector (state, foundation, research) must be provided, also avoiding political overtones at the same time. However, to what extent can pension savings be based on voluntary basis is an important question. As far as we are concerned, we would like to build on voluntary savings in the case of the childless. On the one hand, in order to avoid any references to the unsuccessful 'mandatory.' The infamous former second pillar is still considered by many as 'the state

took our savings'. This could influence the fate of every reform proposal related to savings.

We would like to believe that the Hungarian society is of full age. We would like to believe that the people are able to identify their own interest with sufficient clarification and information. Unfortunately, this assumption does not always hold its own. We may seem idealist in this sense. Perhaps there should be some form of mandatory savings obligation. There are a lot of misconceptions in people's heads. Probably because the pension savings would be dominated by an atmosphere of distrust, it would not matter that this time it would be a newer and improved version entrenched with guarantees. In light of the foregoing, a comprehensive change could only be started with extremely careful preparation and communication strategy.

To that end, it is possible that some kind of 'mandatory', but at least automatic, element should be integrated into the system. For instance in the manner Nobel prize winning *Thaler* proposed it. The essence is that the mandatory nature would be resolved by making entrance into the savings scheme automatic for everyone. But they could exit if they wanted to. So it would not be mandatory by all means. According to *Thaler*, however, being aware of the stress of powerlessness occurring in people, the majority of them would not make the efforts needed for exiting. This way, the system could qualify as voluntary, but hopefully it would still ensure the necessary large numbers of participants. (The brief summary of the proposal can be read in Peter E. Ear's review on *Thaler*; Peter E. Ear, 2018)

*It is, indeed, owned by the payer*

Why is it unambiguous that the proposed private savings is different than the previous second pillar aimed at pension savings? First

of all, it would not be redirected from the mandatory contribution payment. This is the essence! It would mean extra savings from the wage of employees in excess of contribution payment. This immediately raises the question whether young people will be able to save extra amounts especially from their starting salaries for such distant goals. Especially considering that renting an apartment costs fortunes today. Still, we think that even if with a small starting sum, savings should be started at an early age. This voluntary pension fund scheme does, in fact, resemble the former second pillar in that they both are asset-based funded schemes that would be owned by the payer. The question is: can the trust of Hungarian citizens be earned for this scheme? (It must be highlighted by all means that this scenario is, indeed, about savings generated from net income, which *cannot be taken away from citizens*, as opposed to the redirection of the second pillar, which was not, in fact, the money saved for financing themselves, but the part of contribution payable to the people raising them.)

Our proposal, nonetheless, connects the system with demography, which is a crucial issue from the point of the subsistence of Hungarian society. Finally, we came to the conclusion that *Hans-Werner Sinn* did: a complex system is needed, which combines the pay-as-you-go system with the children channel (Sinn, 2001; 2004). It combines the dividing-imposing work pension systems with a human capital-based and/or asset-based scheme. Our proposal is, therefore, to complement the current work pension scheme (or a better, score-system version of it), which could only provide low income at elderly age according to current calculations, with a children-based second pension channel, and, in the case of the childless, with an asset-based pension fund channel. It could be an interesting proposal that the two forms (pension savings and having children, as pension funds) could even provide

a possibility of transitioning from one to the other. (Especially if the pension savings were compelled by laws.) For example, every first-time employee would start the (mandatory) private savings, the extent of which could only be reduced pro rata when the employee found his/her partner and started to have children. In the case of three children, the burdens of this (forced) savings arrangement could be practically eliminated 'on the go', similarly to the debt of housing loans taken out for having children, and so the person could transition to the children-based scheme. Instead of pension fund savings, citizens could be entitled to pension on the basis of their children, as those having children would 'fulfil' the savings with bearing the costs of having the children (what they have saved so far would be owned by them by all means). It should be decided whether this form should remain available for those wishing to keep it (as they can afford to pay it), as a form of complementary pension insurance. But it should not be mandatory for them, if it brings burdens, because they have to spend on their children on a continuous basis, too.

The question how the basic pension (work pension) itself could be reformed into a more just and reasonable solution (for example by making the old and new pensions more proportionate, etc.) would be the subject of a different study. However, the two-fold addition: the child-based channel and the pension savings scheme would provide a desired, necessary and just solution for everyone, including the childless. And, as such, it should be decided by politics whether the preparations of the reform should be started.

## SUMMARY

A paradigm shift is needed in the pension system. The insurance paradigm must be changed to an investment paradigm, and,

basically to the return of the investment into human capital. It must be made clear: we don't 'save' for our older selves, we repay our predecessors what they invested in us. However, in the case of the calculation method of the basic state pension, the entitlement for future work pension would still be determined based on the amount one could expect pro-rated to their contribution payment, assuming forty years of service. Therefore, work pension would remain pro-rated to income. It would, however, be complemented by the second

channel payable based on children or based on the voluntary pension fund. The proposed pension reform would be important primarily because it would result in greater justice. It would, however, be a viable step. It would not place burdens on the budget in the present. It could have a significant role in strengthening family solidarity. In the longer term, it would also influence the equilibrium of the pension system. The appropriate forms of social communication could be found for it without a doubt.

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#### NOTE

<sup>1</sup> The concept of unconditional basic income is a concept that has existed level for long on an international level. (There was already a referendum about it in Switzerland.) If consumption cannot increase, economic growth may also slow down. There is a lot of truth in these opinions. It is not a coincidence that Nobel prize-winning economist Joseph Stiglitz or leading American economist Robert Reich also emphasize (Stiglitz, 2015; Reich, 2017) that the direct support

provided to poorer layers of the society is more useful for the economy than the tax allowance, which is applied in Hungary, too. Taxes can be paid by those who have (perhaps higher) income. Wealthier people, however, increase their consumption to a smaller extent than the poorer. These economists claim that as a result, from the point of growth, it is more efficient to allocate the subsidies to the poorer directly than to allocate them indirectly to the wealthier through the taxes.

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