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The Financing Reform of Social Security

How to Kill Many Birds with One Stone?

Summary: One of the most severe problems affecting the economy in Hungary according to domestic entrepreneurial organisations [National Association of Entrepreneurs and Employers (VOSZ), Hungarian Chamber of Commerce and Industry (MKI), Hungarian Association of Craftsmen's Corporations (IPOSZ)] are the extremely high charges on labour. Is this assertion true and if it is, what sort of real opportunities are there to substantially reduce the charges? How did this high level of charges come about; why is it unsustainable for the future; what sort of international models and experiences of its reduction exist; and what sort of consequences such high levels of contributions have on our competitiveness, the pervasiveness of the grey economy, and the socioeconomic problems of pensioners? It is posited as the hypothesis of this paper that not only is it possible to reduce the existing contribution burdens in Hungary substantially, but it is also our duty to do so. By taking this step, we would also be able to significantly alleviate several of our economic and social problems. And although we would obviously have to replenish the funds necessary for the operation of the system, a combined system (partially financed from wage-related contributions and partially from the central budget) would not only solve the sustainability issue of social security, but by improving competitiveness it would also contribute to our country's growth.

Keywords: social security, fiscalisation, economic policy, charges on labour, reform
JEL code: G28; H26; I13; H24; H55

Currently in Hungary, the rate of the pension contribution payable by employees is 10% of the gross salary; whereas health insurance and labour market contributions account for an 8.5% charge on salaries. The recently reduced personal income tax is added to these burdens, which are further adjusted by the tax benefits available after children (which further improves employees' net positions). At the same time, however, employers are responsible for the payment of social contribution (currently 27%) as well as the 1.5% vocational training contribution. Larger employers also have to pay a rehabilitation contribution as a lump sum determined on the basis of the number of employees they have.

At first glance, the system appears to be overly complex and difficult to negotiate (and it is), however, it is a great improvement over the system in place until the end of 2010, when employers as well as employees were required to pay different types of social security contribution under a number of different legal titles. The greatest fault of the system, however, is not its[1] complexity, rather it is our belief that the different types of charges increase the burdens on labour significantly and therefore curtail employment.[2]

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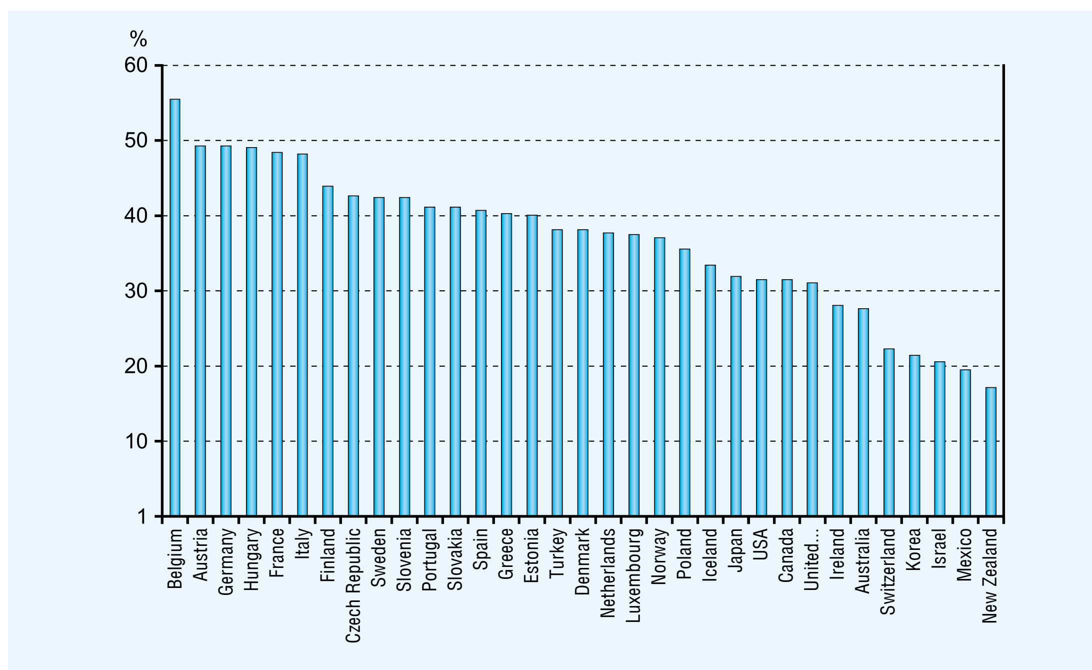
As a result, the study focuses on the expediency of changing the sources of financing in the medium-term (by way of a 5–10-year programme and with a similarly scoped outlook). The features and challenges of the two largest social security schemes (the pension and healthcare schemes) will feature in our study to the extent that they are necessary for us to understand them, and because a financing crisis of these systems is impending, we consider it necessary to create a strategy and prepare for its preliminary debate in a planned and goal-oriented manner to ensure that the specific steps of the strategy can be executed as quickly and with as few interim modifications as possible. The reason why we have placed greater emphasis on pension schemes and their financing requirements is because they represent nearly double the financing burden compared to healthcare system expenditures, and because they are much more determined by demographics and regulatory features. (In addition, healthcare has always operated on the basis of the principle of residual resources, as it is common knowledge that no amount of funds is ever enough to spend on healthcare and on providing everyone with the highest level of care possible...) Therefore, the objective is to draw up a reform that is not only able to ensure the sources of the existing financing requirements in the longer term but one that can also provide an answer to the employment, competitiveness and grey economy reduction challenges of Hungary. The study, naturally, would only be the first step towards this goal.

Due to the tax benefits and family allowances available after children, the charges on

Figure 1

PUBLIC CHARGES ON WAGES (TAXES AND MANDATORY SOCIAL SECURITY PAYMENTS) IN PERCENTAGE OF WAGES IN 2014, AS PER 100% OF AVERAGE EARNINGS OF UNMARRIED PERSONS WITHOUT CHILDREN N 2014



Source: OECD, 2015

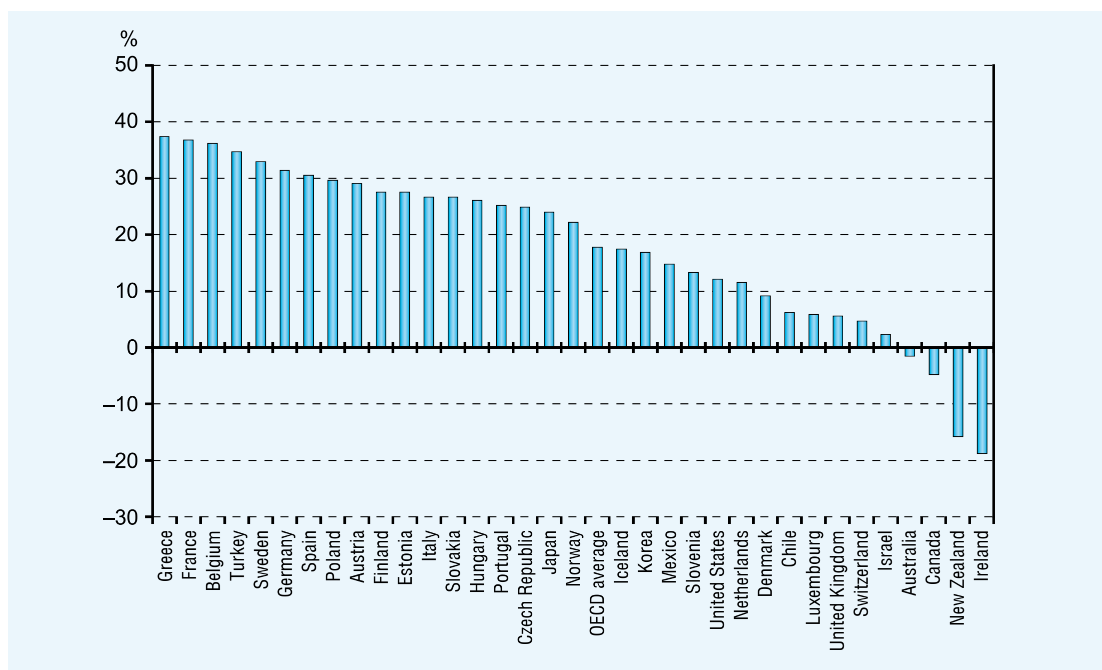
wages have a different effect on families depending on their family and income status. When it comes to unmarried employees with average earnings, according to the statistics of the OECD, in Europe only Belgium, Austria and Germany surpass Hungary in terms of public charges levied on wages. The latest OECD figures are shown under *Figure 1*.

Due to the fact that Hungary has a flat rate personal income tax system, the burdens experienced by low income individuals are very high. It comes as no surprise then that EUROSTAT's analysis on tax and social security burdens concluded that: In Hungary, the charges on the wages of low income employees are relatively high compared to other European countries. The highest tax burdens on low income earners in 2013 were recorded in Belgium, Hungary, France, Germany, Italy, Austria, Romania, Latvia and Sweden (all above 40.0 %). On the other hand, the lowest tax burdens for low income earners were recorded in Malta, Ireland and the United Kingdom (below 30.0 %) as well as in Cyprus (latest data from 2007). EUROSTAT, 2016

These high levels of charges are mitigated in Hungary by the allowances available to families and individuals with children, therefore, the situation of employees with two children is much more favourable. In an international comparison (OECD), the charges on wages are still considered high in this group as well (above average), as it is evidenced by the figures cited under *Figure 2*. The difference is particularly striking in comparison with countries where all the charges on wages are negative i.e. there is a positive balance of wage transfer to the benefit of people in these

Figure 2

PUBLIC CHARGES ON WAGES (TAXES AND MANDATORY SOCIAL SECURITY PAYMENTS) IN PERCENTAGE OF WAGES IN 2014 FOR A PERSON WITH TWO CHILDREN, RECEIVING 67% OF AVERAGE EARNINGS



Source: OECD, 2015

income groups (Australia, New Zealand, Canada and Ireland).

WHAT ARE THE EFFECTS OF EXCESSIVELY HIGH PUBLIC CHARGES ON WAGES?

High public charges on wages turn labour disproportionately more expensive, which has an added negative effect on competitiveness. At the same time, the issues that arise are not limited to competitiveness:

- compared to the high charges on labour, other resources become relatively inexpensive, resulting in a lower level of employment;
- untaxed employment is aided, as employers either do not register their employees or only do so partially (for example, they pay them the minimum wage officially and give them the rest of their pay in cash), which situation drives up the charges paid by the "remaining" legally employed employees in order to ensure that the social security budget breaks even;
- "brain drain" cannot be stopped, because a significant part of the high wage costs at home go towards the payment of contributions and taxes;
- employees employed with suppressed wages create social problems,[3] because after they retire they will not be able to support themselves from their low pensions (as pensions will only be paid after the legal part of their pay) and will not be able to maintain an acceptable standard of living,[4] and the situation is going to create a permanent pressure on decision-makers to increase the lowest pensions at a higher degree than the average pensions, which is going create pressure to raise contribution burdens further;
- in terms of competitiveness, Hungary has not only assumed a disadvantaged position globally as well as regionally (in comparison with the neighbouring countries), but stakeholders in the SME sector will also suffer the negative consequences of employing people entirely legally; therefore, high contribution burdens further encourage the growth of the grey zone, which also impedes upon the achievement of the desired goal of the successful growth of companies. That is because it is obvious that above a certain size, it becomes increasingly difficult not to employ people legally.[5]

As a result, we have a recurring model, where the mechanisms of operation perpetrate the conservation of the same situation, acting towards it becoming worse and more distorted instead of improvement. Therefore, the only way to step out of this model is to change the incentives: however, as long as the burdens on labour are disproportionately high that remains an impossibility. Therefore, only the drastic decrease in the contribution burdens of personal allowances can be the remedy. (The reduction of the burdens of fringe benefits or an increase in the sum available for fringe benefits therefore is not the solution,[6] because although it can increase the living standards of employees, the amount of contributions paid into the central systems will be lower. The reason behind it is that in such a scenario employers and employees will turn to cafeteria instead of increasing wages, as compensation.)

Although the government already recognised the high level of charges on wages at the outset of its term of government in 2010 as an area of concern, it saw the solution in the gradual reduction of the rate of personal income tax and the increase of the family tax benefits instead of the reduction of contributions. However, the reduction of the contributions payable by employees could be an alternative to income tax rate reduction, which

step would require that the social security funding lost as a result be replenished from other taxes later on. We are going to elaborate on this in more detail.

However, it must be noted in addition that the social security system in Hungary is currently suffering from a set of grave problems that do not allow for a quick or simple change. One must not forget that the largest item of social security is the pension scheme, which is already in a serious crisis due to the deteriorating demographic situation. Therefore, a simple cut in contributions would not be a viable solution. At the same time, the deteriorating demographic situation is hitting the healthcare system hard as well, because the ageing of the population brings with it an increased need for more and costlier medical interventions. Another great problem is the emigration of medical personnel (medical doctors and nurses), as a result of which reducing financing in the healthcare system is not possible (or at least would not be right) either. All of these combined require us to draw up complex proposals that can simultaneously ensure the following:

- on the one hand, to significantly decrease the charges on wages;
- to not jeopardise the basic elements of the social security system (the pension and healthcare schemes), furthermore to increase their sources of funding if possible.

These two tasks are not easily carried out simultaneously. It will, however, become necessary if we are to keep our society operational.

THE HISTORY OF THE EVOLUTION OF SOCIAL SECURITY SYSTEMS, THEIR MAIN TYPES AND DILEMMAS

Due to the fact that social security burdens feature disproportionately high within public charges on wages, we will investigate the possible ways of reducing them in absolute and relative terms and explore what alternative sources would be available to alleviate the financing problems of the social security system. The next part of this paper will rely on the pension and healthcare analyses of the OECD and WHO[7] as well as analyses of the social security schemes of EU countries and Latin American countries.[8] As regards the domestic pension scheme, the paper will rely on the excellent works of *Mária Augusztinovics* and *András Simonovits.*[9]

The full content and coverage of social security within the individual countries is neither obvious nor identical. Social security is usually interpreted as containing the old-age pension and healthcare schemes. In certain countries, however, social security also includes accident insurance, unemployment benefits, family benefits, childbirth allowances as well; although in many cases these benefits are provided within the framework of other schemes. In many European countries, such as the United Kingdom and a few Scandinavian countries (Sweden, Finland[10], Norway), public healthcare benefits are not part of social security. In the United Kingdom, the healthcare system (National Health Service – NHS) has been financed from the central budget since 1948, whereas in some Scandinavian countries the healthcare system is operated jointly by the central government and the county and local governments (in a system of divided responsibility). In both countries, health insurance operates within the framework of central budgetary financing – while the service providers can be state run or private providers.

In terms of its history, social security (as is evidenced by its name) has evolved from a single security – primarily self-providing – system. Therefore, insurance premium-type payments proportional to wages still figure highly in the financing of social security systems. It is noteworthy that although the system in Hun-

garian is called társadalombiztosítás (social insurance); in English it is called social security and in French it is referred to as sécurité sociale (which terms mean security rather than insurance). Therefore, the English and French terms – not coincidentally – are not synonyms of the Hungarian term, and actually denote a different meaning. This is important because although social security worked as a type of insurance in the beginning, in many countries its nature and method of financing have begun to change later on.

It is common knowledge that the origins, roots of today's social security systems date back to Bismarck's Germany, the English welfare state, the American New Deal, social democratic continental governments and the workers' welfare system created in the Soviet Union. In the beginning, the states have chosen the simplest and most inexpensive solution available to them: they simply made it mandatory for certain social groups (mainly people working in certain industries) to join the existing basic voluntary social security system and then required employers to pay contributions in proportion to the wages paid to the workers. Only later did the governments of a few countries begin to contribute themselves to the operation of the social security system.

Obviously, social security schemes operated differently in different countries (and it is still the case today). It was, however, a frequent occurrence that a certain kind of self-governance has also played a role in the operation of these systems that have already become mandatory and increasingly comprehensive; the supervising bodies of which did not only comprise the representatives of trade unions and the state but that of employers as well. In Hungary, this type of self-governing social security system was in place for a few years following the regime change.[11]

The wide-ranging tasks of social security, however, are not all performed by the social security schemes in every country, rather they are (at least partially) covered from the central state budget. The "operation" of certain benefits in many cases are delegated to separate subsystems. In addition to the English healthcare system already mentioned, it is also common for unemployment benefits to operate in a non-insurance format. The roots of this phenomenon are usually purely historical, as they have been established separately at different times and therefore – despite every logic – are still being operated as separate systems today. Moreover, it is not an easy task to transform the self-governing systems of social security, even in countries where trade unions and employer organisations are strong.

One of the most important subsystems of social security is the old-age pension scheme. The two most commonly known and distinguishable systems operating today are the pay-as-you-go scheme and the fully funded scheme. Let us have a look at these in more detail.

Under the pay-as-you-go scheme, the costs of the benefits are paid by the entire society (or at least by those actively employed) by way of contributions – usually deducted from wages – and the most important feature of the system is that it is based in the present. What this means practically is that the current amounts paid into the system cover the current amounts paid out from the system. This system, however, is very sensitive to demographic changes.[12] That is because as long as a society is growing continuously, there are no problems with contributions: more and more people have to support relatively fewer people. In the case of a demographic deficit, however, the opposite is true: fewer and fewer people have to support an increasing number of pensioners.[13,14]

During the initial phase of Socialism (here in Hungary as well), the introduction of the

system provided a opportunity for extraordinary deductions, because there were very few pensioners for decades, while people en masse have started paying the contributions into the system. Moreover, despite the considerable charges, the Communists managed to assume the role of the saviours of the populace while these changes resulted in drastic burden increases for employees in the short and medium-term.[15] And now – when the problems have started to surface (as a result of the changes in demographics) – another system has to pay the price. This is especially true in light of the extraordinarily high birth rates during the Ratkó period, which have bolstered the pension scheme of the late Socialist regime, the increased pension and health-care costs of which, however, had to be financed by the governments of the next 5 to 25 years.

Beyond the payment of reparations to the victors of the war (primarily to the Soviets), these extraordinary revenues from the new system also allowed for a sort of cross-financing: the large-scale industrialisation of Socialism, following on from the Soviet example, required substantial funds and thus the funds for these extra investments were ensured in this fashion.

The logic is substantially clearer in the fully funded pension scheme (at least at first glance), where a person can only take out of the pension fund as much as he or she has previously paid into it. This was the system in place in Hungary between the two World Wars for certain professions and employee groups. Highly visible (legible) testaments to this are the signs above the entrances of large blocks of buildings in Budapest, which apartment buildings were built for contribution payers that would retire down the line, and for whom the durability of their payments was thus ensured.[16]

Following the regime change, there were two more attempts in Hungary to establish a fully funded scheme, both in the 1990s. The first occurred at the time of the MDF-lead government. At this time, a significant part of the massive state assets available for privatisation was intended by way of legislation to be used within the framework of a self-governing model, led by a controlled advisory body to create a second pillar – in addition to the pay-as-you-go system – a financing by way of using the desired yields generated by the assets. Behind this measure was clearly the recognition that the country must prepare for the retirement of the great generation of the Ratkó-era. However, despite expectations at the time, the body dominated by post-Socialist trade unions was professionally unable to carry out efficient wealth management. As such, the transfer of the hundreds of billions in assets ground to a halt after the government changed in 1994, and in fact reversed at the time of the Horn-cabinet: not only was there no transfer of assets after this, but in fact a re-nationalisation process commenced.[17]

The second attempt ended quite recently: the mandatory private pension fund scheme created at the end of the 1990s was scrapped following the 2010 government change. That is because the EU was not willing to adjust for the current central budgetary deficits taking into account increasing deficit levels due to lost state revenues; in addition to the fact that the newly created system also failed to deliver on the hopes it had raised.[18] It was neither higher in yield, nor lower in cost, and also failed to satisfy transparency requirements.[19] Today (in 2016), remnants of the scheme still exist, but the state has made much of the assets generated ‘disappear’, has paid the yields generated until then to re-entrants and has reintegrated the powers into the state scheme.

Naturally, in the case of an ageing society, the fully funded scheme cannot indefinitely cover the healthcare or pensions of an increas-

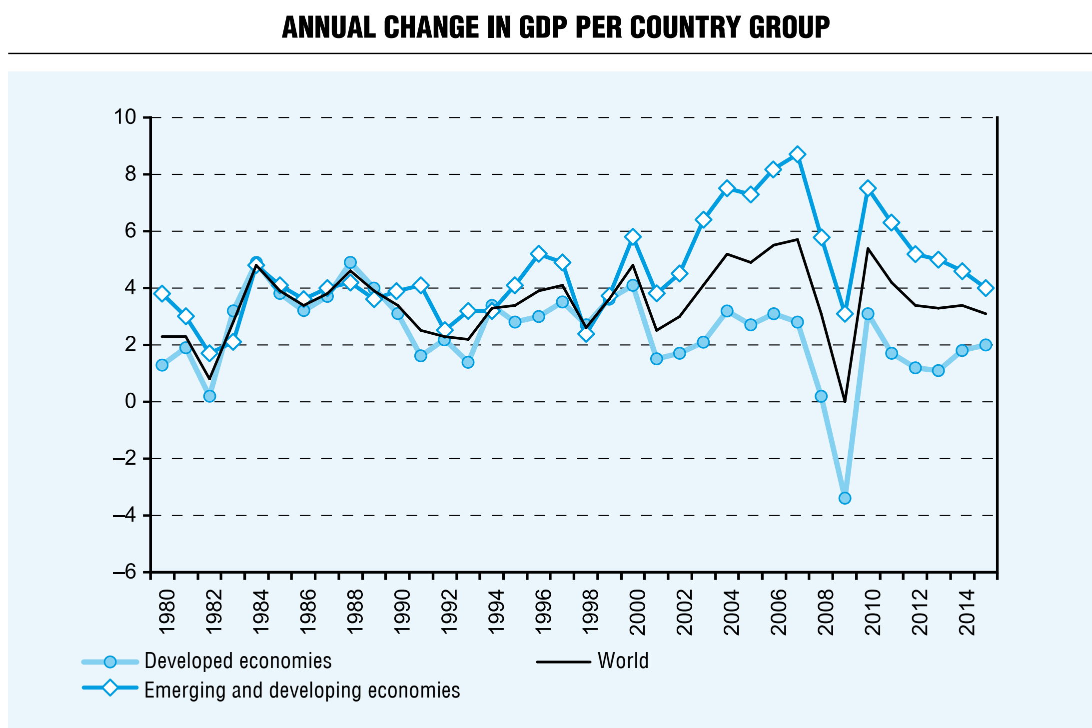
ing population either, unless capital fund managers are in possession of the 'Philosopher's stone' and they are able to increase the value of investments year after year. These are the types of investments where the assets within the pension scheme are invested into regions and industries that grow faster than the developed economies as well as the world average. Long-term convergence is rarely successful in world economy, see for instance the failure that was the rise and fall of the BRIC countries. We have also seen examples of sector-level failures: e.g. 'dot-com bubble' of the turn of the millennium and the subsequent period, where investment funds ran up huge losses after an initial soaring period... The OECD analysis also complains that "in the aftermath of the 2008 economic crisis, the returns of private pension fund schemes are also proving to be problematic due to low yields".[20]

The investment of social security funds (or some of the funds) abroad might serve as partial remedy in the short and medium run, but ultimately this solution is not perfect either. In general, we can say that while population is increasing at a slower rate (or for that matter decreasing) in developed countries, the exact opposite is happening in developing countries with the growth of the population being a typical feature. Naturally, under such circumstances, it comes as no surprise that economic growth is swifter in less developed (also called quickly industrialising or emerging) countries, while growth is slower in developed countries. At the same time, in this faster developing group of countries, the fluctuation and unforeseen volatility of economic growth over time is also greater, as revealed by the IMF's GDP data *(See Figure 3)*.

Another problem is that – if the assets of social security funds in the given (developed) country with decreasing population is for the

Figure 3

ANNUAL CHANGE IN GDP PER COUNTRY GROUP



Source: IMF Datamapper, 2015

most part invested outside of the country – then experience shows that there is insufficient capital left for the domestic economy. Over the past decade, this is what we've seen occur in Japan: the ageing population is not consuming enough, investment funds are not investing into Japanese economy and as a result the country's economy is struggling. As *Marcello Minenna* wrote: *"Japan does not grow because it cannot grow; with a declining and rapidly ageing population, the future potential of the economy is low. The elderly tend to consume less and save more and ... the return of the investment in real assets is meagre at best. ... profits .... have not been reinvested in the economy..."*[21]

In respect of social security – in particular old-age pensions –, based on the recommendations detailed in the publication entitled Averting Old Age Crisis (published by the World Bank (IBRD) in 1994), many European countries introduced the so-called 2 or 3-pillar system, where

- the first pillar is the mandatory participation scheme (which may be either pay-as-you-go or fully funded);
- the second pillar is a mandatory participation scheme, within which there are multiple freely selectable options, typically realised in the form of private pension funds, in other words a fully funded system (it is usually not set out which pension fund must be selected);
- the third pillar, which does not exist everywhere, represents funds that may be selected entirely freely, in other words this is also a fully funded system (not only is it not set out which pension fund must be selected, but people in general are not obligated to save up in this fashion for their retirement years);
- in addition, there are also countries were other options also exist, typically in the form of mixed systems, which in practice means that private capital has also recognised the opportunity for profit generation in the operation of pension insurance systems.

Following on from the Washington Consensus[22], the three or multipillar pension reform was introduced in several Latin American countries (firstly in Chile in 1981 during the dictatorship of Pinochet, then in other Latin American countries as well). As summed up by *Hujo* and *Rulli*, *"More than half the countries in South and Central America had reformed their pension systems: (...) Peru (1993), Argentina and Colombia (1994), Uruguay (1996), Bolivia and Mexico (1997), El Salvador (1998), Costa Rica (2001), Nicaragua, Ecuador and the Dominican Republic (2003), and Panama (2008)*[23]*"*.

After 2008, however, several countries in Latin America withdrew from the private pension fund scheme. As the reason, they cited that many have dropped out from the scheme "primarily on account of the fact that administrative costs were too high and as a result the pensions available were not high enough". The authors also reported that pension coverage also remained relatively low in Chile and Argentina alike, and gender equality was also improved.[24]

It is very likely that the operation of pension schemes as part of state-operated or private systems is greatly related to the political commitments of the ruling governments of the given countries (at least that is the case in developing and emerging countries). Clear correlations have been observed in the case of Latin America: left-wing governments tend to steer towards pay-as-you-go state-managed pension schemes that ensure increased solidarity, while right-wing systems tend to opt for private pension schemes. (It will be interesting to see where Argentina, where right-wing government has again risen to power, will progress from the Kirchner-type pension re-

form that introduced elements of the state-managed system.)

In addition to pension schemes, there is also great diversity around the world in respect of health insurance,

- from the fundamentally state-funded scheme;
- through mandatory participation systems that operate only a single health insurance fund (typically financed from wage contributions, or on occasion deficits filled up from the central budget – with a similar system functioning in Hungary as well);
- through mandatory participation systems that have several undefined health insurance funds (where the amount to be paid mandatorily for a given income is set out, but not which funds must be selected, an example of which is the French system);
- all the way to the scheme where, in addition to the mandatory basic insurance, people can optionally take out additional insurance (entitling to additional care) (many countries have similar systems, including Hungary, were additional insurance can be taken out with health insurance funds).

In insurance-based schemes, contributions are usually weight-proportionate and in some cases people themselves have the option to decide which – non-mandatory insurance – they choose. There is also no uniformity in whether patients must pay partial contributions for the services used and whether the entire cost must be borne by the patient in advance, to be refunded for the majority of the amount subsequently (as seen in France) or whether the smaller part of the amount is to be paid subsequently. The case is the exact opposite in the Swedish scheme, which is funded for the most part through the budget: citizens do not have to pay above a certain limit, but in fact all healthcare payments are covered by the budget above the given limit (2,200 Swedish krona/year).

POSSIBLE RESOLUTIONS OF THE CONTRADICTIONS OF THE SOCIAL SECURITY SCHEME

Of course, the contradictions in social security financing have been detected by many, and multiple solutions have been put forward to manage these. In respect of demographic problems and disproportionately high charges on wages, the following solutions have been drafted in recent years:

- certain proposals suggest that increasing the population's willingness to have more children through the changing of the social set of values could be the solution to counter the ageing of the population[25];
- another potential solution is to increase the population's willingness to have more children through the child-based pension scheme;
- the third opinion states that the solution would be to encourage the population's self-provision through the fully funded scheme, which would at the same time help preserve the value of pensions without having to raise pension contributions;
- the fourth proposal package is the immigration option (the essence of which is to attract young, diligent migrants from undeveloped countries to ageing regions, migrants who are able to bear many children), which solution would alleviate the labour shortage and competitiveness issues while also avoiding the reduction of benefits and allowances;
- the fifth, and otherwise obvious 'remedy' would be to raise the retirement age limit (which would also have a positive impact on the financing of the healthcare system);
- the sixth solution (the option that relies on the whole of the budget) would be to finance the deficit of the social security scheme from sources that are more difficult to deplete, sources other than charges on wages.

- and finally, according to the seventh solution[26], the burdens on Hungarian labour must be reduced, which would be covered by the reduction of red tape.

However, the aforementioned solutions rarely create 'pure' systems. For the most part, countries attempt to introduce a sort of 'mix', combining various therapies on account of the differences in the severity, acuteness, political 'hazard' and cultural background of the given problems. But how effective can these solutions prove to be? – Let us examine this exciting issue together.

The first solution (i.e. improving the willingness to bear children through the change in value systems) seems hopeless even in the long term in today's democratic post-modern societies. It is not very realistic to believe that young people brought up in a post-modern system of values would suddenly return to the pre-modern values of the 19th century. Especially given the fact that in Christian civilisation and in developed countries, a post-modern trend can clearly be observed – in contrast with Islamic cultures, for instance, where the notion of returning to the fundamental values of their religion is currently on the rise and 'a la mode'. This is obviously not how it works.

The second solution − i.e. increasing the willingness to bear children through the child-based pension scheme−could probably work, but its impact would only be felt after a longer period has passed.[27] The scheme proposed (in various studies and lectures) by *Szilvia Szegő, András Giday, Katalin Botos* and *József Botos*[28] is not looking to change the set of values, but simply wants to provide an opportunity for young people − who are looking to have children −to not have to renounce having children for financial considerations. It should be mentioned, however, that numerous countries have already introduced similar measures. An example of this is the new state pension system introduced in Chile after 2008 (Bono por Hijo), but the French pension scheme also contains such elements.[29] At the same time, it must also be seen that the impact of this reform will not be felt overnight, but actually requires several years or even a decade. Moreover, it would require a family-oriented and long-term thinking by the government, the consistent representation of which approach does not seem likely due to the frequency of government changes. Even though there is not much international experience to assess the efficiency of this system, the first results seem encouraging.

We have already talked about the third solution − improving the self-provision of the population − in relation to the fully funded scheme and have also analysed its contradictions. The main problem here is that an ageing population is generally unable to find a portfolio that can increase quickly in the long term and at the same time also guarantee durability in value. Latin America was among the first to apply this model, followed by several European countries, and it ultimately became very popular in Eastern European countries as well. At the same time, interestingly, several Latin American countries withdrew from this after 2008, and instead introduced fundamentally or partially stage-managed pay-as-you-go systems that ensured greater solidarity. Although it is still unclear what the long-term solution will be in this area after the most recent political turn of events.[30]

Although the fourth solution (i.e. the encouragement of immigration) might be technically viable, it is very likely that it would practically undo the society the social security scheme of which they are looking to actually save. People in increasing numbers feel that a society, the majority of which is made up of migrants from the Third World − most likely Muslim migrants − would be just as different from today's traditional Europe as Ancient Rome was different from the Christian Europe of the Middle

Ages. This change, however, could come about just the same. We must still admit, however, that the majority of European residents would like to avoid this happening.[31] Moreover, it would also be difficult to swiftly make the (for the most part untrained) migrants suitable to participate in today's developed economies as employees and workers.[32] In addition, it is also very possible that if integrated, migrants (unless they are able to preserve and maintain their value systems) will also adopt the post-modern set of values, as a result of which their willingness to bear children would drop significantly in a relatively short time (over 1 or 2 generations). In this case, the problem would not be resolved, but simply deferred.

The fifth solution, to raise the retirement age limit, seems to be viable although there are health and physical limits, and it also raises questions in respect of the fight against unemployment. The retirement age limit for men was 65.5 years on average in 2015 in OECD countries, and this is likely to increase.[33] Obviously, if life expectancy for men in a given country is only 75 years, then raising the retirement age much higher than the current limit does not make much sense. The number of probable 'healthy years' should also be taken into account (which in Hungary in 2013 was only 59.1 years). These factors all put a cap on the raising of the retirement age limit. A mixed (combined) therapy could also be developed where the person reaching retirement age could select to receive a given percentage of their pension and could in addition continue working for a lower salary. This would be beneficial for all, as it would create a transition between active and retirement years, and would also allow for the utilisation of the experience and know-how of the older generation. These incentives have proven to be successful in several OECD countries.[34] Such a system could also help in financing the healthcare system, as contribution cycles would be extended.

The sixth method is to cover, in part or in full, the expenditures of the social security system from the budget (in other words, the fiscalisation thereof). In addition, the solution would also allow for a wider spreading of the costs of social security while at the same time – depending on the scope of fiscalisation – increasing the funds available for old-age pension and/or the healthcare system. In one of her key studies on the pension scheme reform, Mária Augusztinovics in 2005 mentioned the idea of a basic pension, financed from taxes[35]: "It appears more realistic to have a guaranteed flat-rate basic pension available to people after a certain age, financed from general taxes rather than wage contributions. The element of solidarity embodied in this idea would not drive up the price of labour; rather it would operate on the basis of redistribution available within the tax system... Recently, as evidenced by the relevant literature, certain authors have also been exploring the possibility of non-contributory pensions (e.g. Schmähl, 2000)."[36] It is interesting to note that instead of aging Mária Augusztinovics considers low employment to be the most important problem of society. This issue cannot be remedied without reducing contributions. With regards to the basic pension, Mária Augusztinovics did not recommend a starvation pension, but rather an amount that would allow for a decent level of sustenance.

The seventh solution – which would cover the contribution reduction from a reduction of bureaucracy – would also practically translate into the partial fiscalisation of social security. It is unclear, however, exactly what funds will remain available as a result of the reduction in red tape.[37]

It is our opinion that, in respect of the ageing of society it is primarily solution number two (the child-based pension scheme), while in respect of increasing the competitiveness of the economy, it is solution number six (the partial or full fiscalisation of contributions)

that could provide a solution and bring about substantial improvement. But most likely Mária Augusztinovics was right: the main problem with the pension system is not actually ageing, but rather the low-level of employment.

The elements of social security fiscalisation can already be detected in several countries today. The healthcare system of the United Kingdom – and in part in Sweden – is maintained from the state budget and financed from taxes. As far as the pension scheme is concerned, we can observe similar solutions in France in the case of the CSG, where the state is continuously making up for the social security deficit.[38]

Instead of implementing the financing reform of social security in a single step, it could also be introduced gradually, with compromises. The most obvious solution would be the fiscalisation of the health insurance subsystem. (In this case, it would be much simpler to transition to budget financing as it would be in the case of a pension scheme, as shown by several examples around the world.[39])

The health insurance system in the United Kingdom (established after 1948), that is financed from the budget, is working efficiently and effectively. The country is positioned high in the World Health Organisation's (WHO) ranking of healthcare systems: It was ranked 18th in 2000 – while the United States, which uses a purely private insurance scheme was only in 37th place, with Hungary in 66th. A similarly favourable situation may be observed in Sweden, ranked 27th.

In the past quarter of a century, steps towards gradually embedding social security into the central budget have been taken. The Healthcare Insurance Fund and the Pension Insurance Fund created as separate and self-governed social security funds during the regime change were integrated into the Contributions Directorate of the Hungarian Tax and Financial Control Administration on 1 January 1999. Afterwards, the social security funds have been regularly supplemented with central budgetary funds. The integration of the social security systems into the tax system was the next step taken towards fiscalisation. In Hungary, central budgetary contributions within the overall revenues of health insurance (HUF 1,925 billion in 2015) amounted to HUF 564,935 billion. That is, over a third of the overall revenues were, in essence, central budgetary contributions.[40]

Another benefit of fiscalisation is that the government's responsibility of how much it spends on health care and pensions becomes clear. In this case responsibility cannot be shifted to the unfavourable, detrimental demographic situation and it would not be possible to play the young and the old generations off against each other so much either.

LESSONS, RECOMMENDATIONS AND SUMMARY – HOW CAN FISCALISATION BE FINANCED?[41]

It has become obvious by now that a social security system that is financed from charges placed on wages in (semi-) peripheral countries facing a deteriorating demographic situation (such as Hungary) is not only not viable, but due to its labour cost increasing effects, it also acts as an obvious impediment to economic development. While at the same time also encouraging the emigration of labour to Western Europe. This situation could be improved by a reduction in wage costs, which in our opinion could only be achieved by the (complete or partial) fiscalisation of the social security system.

Obviously, it must be thoroughly investigated which sources of revenue of the central budget are able to compensate the loss of public charges on wages. For example, special taxes levied on dangerous and polluting prod-

ucts would be good candidates, but their extension would create a conflict of interest and the revenues generated may not be sufficient for a substantial shift. Therefore, other solutions should also be considered.[42]

Without going into detail about other financing possibilities – non-wage based –, we would like to point out that theoretically the options to be considered include increasing turnover, income-based charges (here we are referring to the corporate sector as at this time we do not see that there is any sort of political willingness to return to the progressive personal income tax) and asset-based charges. Increasing turnover-based taxes is only possible to a limited extent due to the already high rates and the danger of increasing the pervasiveness of the grey economy, therefore the only other option is the gradual introduction – concurrently with the strengthening of the middle classes – of property type taxes. (That is because if introduced drastically, the latter can lead to the strengthening of straw man phenomena and the movement of domestically accumulated wealth abroad.) Supplementary sources of funding should therefore come as a combination of different sources.

Apart from these, the possibility exists – and can be realistically calculated – that in the future real wages would increase year on year. That is because increasing wages would have a beneficial effect – on many levels – on solving these financing issues. On the one hand, increasing wages would on their own – due to the growth effect – improve the financing situation, if one assumes that pension payment replacements would only generate a 1% surplus demand and that wages would increase at a higher rate than that. If at the same time, higher wages could even have the added effect of attracting employees currently working abroad to return, that could even lead to a rise in the number of payers. Contributions would also be increased if the ratio of workers employed in the grey economy could be simultaneously decreased. In the future, it would be useful to have model calculations performed on these with different parameters. This exciting question – together with the exploration of the ratio of employed people to pensioners within society in different scenarios – could be the subject of a new study.

As a result, fiscalisation should not necessarily occur in one step all at once. It could begin with health insurance – following the example of the United Kingdom – and then based on the effectiveness and financing of the transition, fiscalisation could be extended to the pension scheme. It is important to emphasise, however, that small shifts do not fundamentally change incentives, and that it is difficult to ensure funding for big changes.

The solution, therefore, would probably be to go step by step along the lines of a programme announced for the long-term. This way, the balance of the systems would not be interrupted while the previous negative effects and incentives could be substantially decreased. The sooner we begin these steps, the sooner we can achieve our target.[43]

Notes

[1] It is worth noting that the complexity of the Hungarian social security system is not unparalleled, as for example the mandatory payments into social security (in terms of distributions and ratios) in France are at least as complex. And it is not a coincidence that the public charges on wages are very high in France as well.

[2] In addition to the issues of job creation and job retention, these high levels of public charges on wages

also have a detrimental effect on competitiveness, the pervasiveness of the grey economy and the socio-economic situation of the elderly, but we will come back to these points later in our study.

[3] For more details, see: Botos K., 2015

[4] From a certain perspective this is a hidden debt, as employers are able to gain an illegal and unjust competitive advantage at the price of creating an additional pension supplementation requirement – after retirement – due to the low pension benefits instead of paying the currently unpaid contributions.

[5] This line of reasoning also shows that this fact (that the ratio of medium-sized enterprises is low in Hungary) is also caused by the charges on labour being high, which acts against growth.

[6] Tax system changes introduced recently have not been moving in that direction either.

[7] OECD, 2015b, OECD, 2015c., and WHO country analyses.

[8] See: Poteraj (2008), and Hujo, K. and Rulli, M., 2014

[9] Most importantly: The works of Augusztinovics et.al. (2002), and Simonovits (2002).

[10] With regard to the Scandinavian countries and the English healthcare system, please see the country analyses published in the „Health in Transition" publication of the WHO.

[11] Find more details on this in the next chapter.

[12] The system is relatively flexible in terms of its ability to adapt to changes in economic cycles, and during crises due to the stable level of benefits they serve as a sort of stabiliser counteracting negative economic cycles.

[13] Therefore, the current mode of operation is in fact a kind of pyramid scheme. That is because it does not matter at all how much a person pays into the system until becoming entitled to the benefit, if there are not enough new entrants the whole system collapses. If, however, there is an adequate number of young new payers, the system remains operational.

[14] Moreover, the reduction in the number of contributors need not only be rooted in demographics, since smaller or larger periods of employment abroad can decrease the number of domestic employees by the hundred thousand. (This however is based on the assumption that those who are currently employed abroad would be able to find employment domestically as well, which we know is not an entirely true assumption.)

[15] It is also a matter of fact, however, that the personal income tax scheme did not yet exist at the time. There was, however, the institution or tradition of the non-paid 'Communist Saturday'.

[16] This capital played a significant role in the construction of the beautiful buildings of our capital city that continue to amaze to this day, as in addition to financial aspects, there was also a sense of tense competition – in terms of the design of the façades and layouts of the buildings – between those who invested in building private condominiums and those investing in the financing of the pension and healthcare schemes. In addition to tax benefits, therefore, another efficient incentive was also instrumental in helping to create the wonderful capital city at the previous turn-of-the-century: and that is the free cash available in the social security system providing a large volume of funds, with long-term returns.

[17] Ultimately both conditions were missing: sufficient assets were not available, and the efficiency and effectiveness of self-governance was also not ensured to guarantee successful operation in the Hungary of the 1990s. See: Botos K., 2015

[18] For more details, see: Matolcsy, Gy.: Egyensúly és növekedés (Equilibrium and growth). 2015, pp. 256–257

[19] When allocating costs, oftentimes out-of-place costs were also booked to private pension funds, and on many occasions parent institutions – insurance companies and other financial institutions – 'forced' their pension funds to purchase their weak or bad products. These manipulations had a negative impact on yields.

[20] OECD (2015b), p. 32

[21] See for instance: Minenna, 2015, pp. 1−2

[22] In respect of the wide-ranging literature on the Washington Consensus, see the two extremes: Stiglitz, J. E. (1998) contra and Williamson, J. (1993) pro. (This latter is really no surprise as Williams actually compiled the documents of the Washington Consensus...)

[23] Hujo and Rulli, 2014, p. 1

[24] See: Hujo and Rulli, 2014, pp. 9–11

[25] In this reading, the new housing grant scheme (the family home creation grant (CSOK) in particular) of 2016 can be classified here.

[26] For more on this, see the announcement made by János Lázár (Portfolio, 2016).

[27] In all likelihood, it would not represent a sufficient solution, in other words another tool – in combination – must also be used to accomplish the desired goal.

[28] See for instance: Szegő, 2011, Gidai, 2015, and Botos and Botos, 2012

[29] For more on this, see: Hujo, K. and Rulli, M., 2014, p. 11, and Feretti, R., 2012

[30] See for instance: Hujo, K. and Rulli, M., 2014

[31] In addition, cohabitation problems and tensions would manifest immediately and not just after a few decades.

[32] We should also keep in mind the global trend that automation, robots and digitalisation is expected to terminate millions of jobs in Europe alone.

[33] See: OECD (2015b), p. 23

[34] See: OECD (2015b), p. 25

[35] We would like to note here that we do not wish to delve deeper into the matter of the basic pension and guaranteed fixed benefits. The reason why the issue of the basic pension is mentioned here is because it would be financed from the central budget, therefore, it falls in line with the basic tenets of this study as well.

[36] See: Augusztinovics, 2005, p. 446

[37] It should also be cleared up – provided that around 100,000 state officials will indeed be made redundant – who will be responsible for performing current state administration tasks and how much this will cost the budget. For more on this, see Portfolio.hu, 2016

[38] For more on this, see for instance: Feretti, R., 2012

[39] We should mention that recently Romania reduced social security contributions, which means that fiscalisation has already been realised in part in this country. In June 2014, the government decided that instead of the 20.8% contribution paid until that point, employers would have to pay 15.8% to the state budget on employee wages. The contributions to be paid by employers for difficult working conditions would be reduced to 20.8 and 25.8% from the previous 25.8 and 30.8%, respectively. (Portfolio, 2014.)

[40] See: OEP, 2015

[41] At this point, we must emphasise that in our opinion, technique is but a secondary issue, the most important question being that financing should not be projected on to labour wages. Our position described in this chapter – concerning technique – is merely a basis for debate.

[42] Of the past decades, neo-classical economists at various ends of the world have spoken out in favour of the introduction of a flat rate income tax as opposed to progressive income taxes or at least in favour of reducing the progressiveness of income taxes. We do not, however, have data as to whether such steps have led to an acceleration in economic development anywhere. On the other hand, there is a lot more data available on how income and wealth inequalities have increased all over the world. (We are here referring to the works of Piketty, Stiglitz, Krugmann, Robert Reich and others.) Naturally, the counter-argument might be that if a country introduced progressive income taxes, then many wealthy people would simply move to another country and the central budget would generate even less tax revenue. This is in fact a realistic threat. However, today at the beginning of the 21st century there are certain techniques out there which prevent people from generating income in a country where they are not paying taxes. The plans of the OECD against transfer pricing already provide tax authorities with a variety of different means of reducing these threats. Another counter-argument could be that the ratio of people with exceptionally high incomes is very low within the population. This is of course true, but according to international research, when it comes to the exceptionally rich their total income and wealth is equal to an increasing number of people's income and wealth. According to the latest report of Oxfam – a civil society organisation established in Oxford in 1942 and present in over ninety-four countries worldwide – published in January 2016, the inequality between people around the world has been continuously increasing. According to the report, the total wealth of the poorest part of the world has decreased by 41% since 2010, while the wealth of the richest 1% has been continuously increasing. (This change is vividly demonstrated by the fact that while in 2010 the wealth of the 388 richest people around the world equalled the wealth of the poorest part of the world, in 2011 the number of the richest people around the world who controlled the same amount of wealth was 177 and in 2012 it was only 159. By 2015, the wealth of only sixty-two of the richest people around the world was equal to the total wealth of the poorest part of the world (see: OXFAM, 2016)

[43] Moreover, with the impending ageing of the Ratkó generation our time is running out...

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