The abolition of the private pension system because of accounting confusion

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I. Introduction

- GOAT among Hungarian economists
- The subject goes back to 2010-2011
- The confusing accounting of the Hungarian private pension system which was eliminated in 2010-2011.
- Is this still relevant?
- Lessons are always useful.
- EU has still a confusing approach.
- The pension bomb is ticking.

„What has happened recently in Hungary to private pension funds seriously undermines trust in the government's respect for private property. What they have done, however, seriously damages the principles of capitalism, and is not far short of crude confiscation." János Kornai, 2011.

II. Fiscal rules

- Central Bank's independence is unquestionable.
- Fiscal policy is the main tool to achieve political goals but fiscal alcoholism is quite frequent around the world.
- Fiscal rules are coming.

	1991	2014
Number of countries:	5	78

- We have to measure. (deficit, debt)
- Benchmarks can create distortions and window dressing. (Eurozone examples)
- Transparency could be the most useful. (Miles-Feretti, Irwin)

III. The adventurous history of the Hungarian private pension system

- 1993. Voluntary Pension Funds
- 1998. Compulsory Private Pension Funds
  - Starting with 2M people. By 2010 3M people has joined.
  - Cooperatives types institution. Limited competition.
  - High cost, low performance during the crisis however they kept their financial stability.
  - Starve the beast. Extra deficit was not a concern.
- 2009. Some groups could opt out. The PRECEDENCE.
- 2010. Nov. Employees Social Security Contribution has been channeled to the State Pension Fund.

III. The adventurous history of the Hungarian private pension system cont.

- 2010 Dec. The capital punishment after two EU refusal.
  - Carrot and stick.
  - Carrot: the real yield has been paid out to the ex members.
  - Stick: Communication
    No more state pension entitlement from 2011.
    Bureaucracy
  - Promises: Individual accounts.
    Ensuring real value.
  - No calculation, no model.
  - 97% opted out.

III. The adventurous history of the Hungarian private pension system cont..

- Budgetary constraint was softening. (János Kornai)
  - Bail out of state companies, institutions.
  - Buying private companies. (MOL, Rába, Eon gas business, etc.)
- Politics.
  - Current pensioners didn’t lose anything.
  - Members lose their money but this was not affecting their daily living standard.
  - Blackmailing. It worked perfectly.
- 2011. Final step
  - Remaining members’ contribution was channeled to the state pension fund as well.
  - They got back the state pension entitlement.

IV. How much?

- 1998-2004 Extra deficit. No EU, no problem.
- 2005-2010 EU accepted a compromise. EU tolerated the extra deficit with a 5 years' of transition.
  - Only 5 years.
  - Crisis was coming. Not a good timing for extra fiscal adjustment.
  - Unprincipled.
- 2009. The 0,1% precedence. EU has been deliberating and accepted the budget improving treatment.
- 2010. summer Refusal of deficit raising.

  Refusal of accepting the 2nd pillar deficit

2010-2011 Baltics, Poland

IV. How much? cont.

- 2011. The outcome
  - 10,7% of GDP was taken over by the budget.
  - Huge budget SURPLUS in 2011 (4,3% of GDP) in line with ESA 95. Published in 2012.
  - Huge budget DEFICIT in 2011 (5,5% of GDP) in line with ESA 2010. Published in 2014.
  - Far the largest statistical adjustment by EU in those years.
  - Yearly 1,2-1,5% of GDP extra contribution in the state pension budget.
  - The government promised at least the same pension equal with the money taken over and the contribution channeled to the state.
  - Implicit pension debt has grown by 10,7% of GDP in 2011 and 1,2-1,5% of GDP every year since 2011.
  - Implicit pension debt is not part of the official debt statistics.

IV. How much? cont.

- 2014. ESA 2010 No more extra revenue. HU consequence?
- 2014- Excessive Deficit Procedure accepts if deficit is continuously declining and getting close to the reference level. Does this make any sense?
- Has the deficit decreased because of the elimination of the 2nd pillar?
  - 1,5% of GDP extra revenue
  - 1,5% of GDP extra implicit pension liability
- What about the government debt?
  - 10,7% of GDP pension money taken over. Implicit debt.
  - 11,2% of GDP extra contribution. (2011-2018) Implicit debt.
  - Official debt projection 71,2% (2018) + 10,7% + 11,2% = 93,1% if the state would followed the business sector accounting principles. But 100% EU compliant.

IV. How much? cont.

- Sacrificing the future?
- The long term pension expenditures.

		Pension expenditures as of GDP								
Year	2013	2020	2025	2030	2035	2040	2045	2050	2055	2060
EU	11,5%	9,8%	9,3%	8,9%	9,1%	9,6%	10,4%	10,7%	11,0%	11,4%
MNB study	10,6%*	9,9%	9,7%	9,3%	9,5%	10,3%	11,4%	11,9%	12,6%	13,4%

***2015**

Source: (EU) European Commission 2015. 347. p.,
(MNB) Freudenberg – Berki – Reiff 2016. 45. p.

IV. How much? cont.

- Winners? Losers? Valuation could have been interesting.
- Long term projections. No transparency any more.
  - 2010. 53 column
  - 2018. 5 column in the long term fiscal projections.
- Demographic projections has a real chaos.
  - EU 2015 projection for 2060. 9,2M people.
  - HU government 2017 for 2060. 7,787M people.
  - Where is this difference coming from?

V. Conclusions!

- EU statistical inconsistency (2004-2018) caused not only transparency issues but resulted serious actions by the Baltics, Poland and mostly Hungary.
- EU approach created distorting incentives. Hungary has sacrificed the short term advantages for the long term losses.
- Implicit pension debt should be part of the debt statistics.
- Hungarian state debt has not declined since 2011 if we calculate the real economic debt including the implicit pension liability and if we believe that the state can keep the promises of 2010.

V. Conclusions! cont.

- The current EU practice predestinates the chance of any private pension reform. No country would be brave enough to take the risk of such deficit increase. (Oksanen, 2013)

„The institutional conditions, forms of behavior and regularities which produce the phenomena described in this book are not externally imposed or immutable. The Hungarian reform of 1968 itself illustrates the proposition that deliberate human action can change them.” János Kornai, 1980.

Thank you for your attention!

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