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Hungary: pension counter-reform as a cure for budget deficit

The Hungarian parliament on 13 December adopted an amended pension act, which will enable the transfer of funds from the private to the state-controlled pillar of the pension system. This move will improve the condition of public finances in the short term and enable the budget deficit in 2011 to be maintained within the 3% of GDP limit agreed with the International Monetary Fund. However, at the same time, it is spoiling the investment climate and will have an adverse effect on public finances in the long term.

The Hungarian parliament, owing to votes cast by the governing right-wing politicians, amended the law on the public and private pension system applicable in Hungary since 1998. According to the new regulations the obligation to pay premiums to the second, private pension pillar will be lifted, and the funds deposited in it so far (over 10 billion euros, accounting for approximately 10% of GDP) will be transferred to the Pension Reform Fund established under the amended law. Pension funds members will be automatically transferred to the state-controlled pillar and will be able to remain in the private pillar only upon having submitted a proper application.

The state's takeover of money from private pension funds will contribute to a reduction of the budget deficit. This will reduce Budapest's needs for financing the deficit with loans, which has been the government's main objective. At the same time, considering the negative demographic trends, the return to a state-controlled pension system will mean significantly higher expenses for the state budget in the longer term. The actions taken by Viktor Orban's government with regard to the pension system will also adversely affect the investment climate because they not only have undermined the balance of public finances in the long term but also are having a negative impact on the prospects of capital market development in Hungary. They have also entrenched the belief among investors that the government prefers solutions which temporarily improve the budget situation to those which lead to a continuation of structural reforms. <boc>