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First Pillar May Also Weaken From the Privatisation of Private Pension Funds

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Private pension funds have been in the focus of both the previous and the current government. The law enacted last year, then reversed as a result of the constitutionality concerns raised by the then president of the republic, László Sólyom, aimed at the amalgamation of the funds into the private pension insurers of financial institutions. The current bill implements the integration of the 8% contribution payable to private pension funds in the state pay-as-you-go scheme in the next 14 months.

Under the current circumstances we should put aside the current political dimensions of the issue and review the purely theoretical foundations of the Hungarian pension scheme. Based on the method of financing annuities, we distinguish so-called pay-as-you-go and fully funded schemes. We distinguish mandatory and voluntary schemes according to the nature of the contribution obligation. Basically all institutionalised pension-financing organisations can be classified according to these two criteria, including the Hungarian pension scheme.
In terms of the real problems underlying the Hungarian pension scheme, each pillar suffers from different problems. Demography is the biggest weakness of the first pillar, that the current trends will become unsustainable by 2050: The ratio of pensioners to contribution payers will be 103 per cent over the current ratio of 76 per cent.

The weak point of the second pillar – private pension funds – is linked to state regulation and the corporate culture of the funds. The state is responsible for the decade-long lack of annuity regulation, while the private funds are performing poorly in terms of operating costs and yields as a result of a lacking responsible corporate culture. A major obstacle to the strengthening of the third pillar of self-reliance, and to its consolidation in Hungarian society, is the regular amendment of savings related legal regulations, the resulting uncertainty, which is further hampered by the poor financial culture of Hungarian households.

In terms of the conceptual and theoretical implications of the second pillar's nationalisation, the long-term sustainability of the state pension scheme may fall victim to the process. The biggest advantage of the mixed scheme for citizens will have been eliminated: the individual sharing of risks between the pay-as-you-go and the fully funded schemes. Individual private pension fund savings, which could be inherited until now, will flow into state funds, possibly strengthening demand for state care and drastically reducing the propensity for self-reliance.

Due to the blockage of membership fees for 14 months, private pension funds may face serious liquidity problems. Cash flow problems – posing a risk to day-to-day operations – may already surface in the first months. But if the plan of the government is realised, and no restrictions will apply to switching to the state pension scheme, the withdrawal of HUF 2,700 billion in current savings may threaten the government securities market, the Hungarian stock market and retail lending related to mortgage bonds.