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Pension Reforms in Poland and Hungary from the Legal Perspective – similarities and differences

The success or failure of national pension policies and reforms has ever stronger repercussions beyond national borders, because the economies and societies of the Member States are becoming more and more integrated. This article is an attempt to compare legal solutions and their resonances for the pension systems of two countries – Poland and Hungary. These states have a similar history and similar experiences. Noting the far-reaching similarities both in the process of public system reform and its reversal was the pretext of such an attempted comparison, and its results were obtained by the authors using normative analysis. Hungary and Poland have higher shares of pension expenditures than the average level. The lack of sufficient pension contributions led to an increase of the public debt to a dangerous level. So the direct reason for the Polish and the Hungarian changes are purely fiscal and come down to improving the situation of public finances.

Key words: pension system, social insurance, pension funds, PAYG.

Introduction

Longevity, growth and the transition into retirement of the baby-boomers have far-reaching economic and budgetary consequences in the EU, reducing the economic growth potential and exercising pressure on public finances. These prospects have been further aggravated by the financial and economic crisis. Sluggish economic growth, budget deficits and debt burdens, financial instability and low employment have made it harder for all pension systems to deliver on pension promises. Pay-as-you-go pension schemes are affected by falling employment, and hence lower pension contributions. Funded schemes are affected by falling asset values and reduced returns. As the economies and societies of the Member States are becoming more and more integrated, the success or failure of national pension policies and reforms has ever stronger repercussions beyond national borders[1].

This article is an attempt to compare legal solutions and their resonances for the pension systems of two countries – Poland and Hungary. These two states are not randomly selected[2]. These states have a similar history and similar experiences. The painful history of the funded part of the basic social insurance system in both countries is to provide a starting point for a discussion of the developments in determining the boundaries of state intervention in post-socialist countries, and controversies[3] arising in the context of understanding the role of the state in providing pensioners with social security[4].

Noting the far-reaching similarities both in the process of public system reform and its reversal was the pretext of such an attempted comparison, and its results were obtained by the authors using normative analysis. The article's confines did not enable a deep analysis that could constitute the next step in comparative legal research.

1. The Polish perspective

1.1. The principles of operation of the funded part of the basic pension scheme before the reversal

a) The place of the funded part in the social security system

On 1 January 1999 the old-age pension scheme reform came into force. The old-age pension scheme is composed of two parts – the basic social security pension (in the typology frequently used in Poland, this is known as the 1st and 2nd pillar) and complementary pension schemes (in Polish typology the 3rd pillar). Based on the classification criteria below, the old-age pension scheme may be presented in the following way:

1. White Paper, An Agenda for Adequate, Safe and Sustainable Pensions – Brussels, 16 February 2012, COM(2012) 55 final.
2. For wider reading about pension reforms in selected countries and the impact of a specific design of the pension system on participants, for the state of the economy and public finances and the redistribution of income between the working generation and generation who have already completed their professional activity, M. Szczepański, "Reformowanie systemów emerytalnych – porównania i oceny" (Poznań: Publishing House of Poznań University of Technology, 2013).
3. See for example: *Przegląd funkcjonowania systemu emerytalnego. Bezpieczeństwo dzięki zrównoważeniu* (Warszawa: Ministerstwo Pracy i Polityki Społecznie i Ministerstwo Finansów, 2013) and Dariusz Adamski, "Konstytucyjne konsekwencje najnowszych zmian w OFE", *FOR analysis 10* (2014).
4. According to Art. 67, section 1 of the Polish Constitution: "A citizen shall have the right to social security whenever incapacitated for work by reason of sickness or invalidism as well as having attained retirement age..(...)".

Table 1.

Number of pillar	Name of the retirement benefit	Legislation relating to the retirement benefit.	Financing method	Participation
1st	Basic social security pension	the Act of 13 October 1998 on the social insurance system	Pay as You Go	Mandatory
2nd	Basic social security pension	Act of 28 August 1997 on the organisation and operation of pension funds	Funded	Mandatory until 31 July 2013[5]
3rd	Complementary pension scheme		Funded	Voluntary
	Occupational pension schemes	Act of 20 April 2004 on occupational pension schemes		
	voluntary fund operates an individual retirement account, (IKE) and individual retirement savings account, (IKZE),	Act of 20 April 2004 on individual retirement accounts and individual retirement savings accounts	Funded	Voluntary
			Funded	Voluntary
	products of private insurance	Act of 23 April 1964 on the civil code Act of 22 May 2003 on insurance activity	Funded	Voluntary

Source: own study.

The Open Pension Fund is only created by the General Pension Society (Article 9, subsection 2 of the Act on the organisation and operation of open funds[5]) for an indefinite period of time (Article 11 of the Act on the organisation and operation of open funds). Creating the fund requires arranging its status. This is executed by the society, which functions as a joint stock company. Setting the Open Pension Funds as a legal entity and classifying this person in the legal system causes some inconvenience related to the short time in which the legal doctrine was formed and the peculiarity of the institutions that remain under the influence of both public and private law. As pointed out in the rationale of the draft Act of 28 August 1997 on the organisation and operation of open funds[6] – "the choice of the legal construction of pension funds as a legal entity was performed in full awareness of the situation. Such a conception of a pension fund assures more safety for the fund's assets than the estate conception". Thus it is described as an "empowered estate that – being a legal entity – becomes a so-called "owner" of the property rights to the securities, and therefore the only subject entitled to them". Needless to say, Open Pension Funds are not subject to ownership as defined in the property right.

Article 6, subsection 1 of the Act on the organisation and operation of open funds says that the contributions, stocks and government bonds (purchased by the Open Pension Funds) "constitute the assets of the Open Pension Funds". So it is assumed that the Open Pension Funds are – having a legal personality – a separate estate which was created from the contribution paid by the members and rights purchased due to these contribution[7]". The General Pension Society investing

5. The Act on the organisation and operation of open funds of 28 August 1997 (Journal of Laws (Dz. U.) 2013, item 989, as amended)
6. Page 11 of the rationale of the act published in the Journal of Laws (Dz. U.) of 1997, No. 34, , item 189.
7. M. Zieleniecki, "Podmioty wykonujące zadania z zakresu ubezpieczenia emerytalnego", *Studia Prawno--Ekonomiczne* (Legal-Economic Studies) 20 (2004), 128.

– in a legal sense – the Open Pension Funds' assets does not operate in their interest but in the interest of the insured who have the opportunity to commit the assets to their own funded pension.

b) The distribution of contributions between the PAYG and the funded part of the basic social security pension scheme

In accordance with the assumptions of the 1999 reform, a part of the mandatory pension system is funded from a contribution of 19.52 taken from the gross salary[8]. It is partly gathered in an earmarked fund governed by the Social Insurance Institution, which is recognised as the Social Insurance Fund (constituting the PAYG part of the basic pension system),. The remaining part goes to the Open Pension Funds governed by General Pension Societies existing on the financial market as joint stock companies (these make up the 2nd pillar of the system). Until recently, we were able to witness the accentuating of the similarity of these pillars, which resulted from the accepting of the defined contribution rule in the pension system. This rule means that future pension benefits depend proportionally on the contributions paid before – to be precise, on the gathered pension savings[9].

Until 30 April 2011, part of the contribution collected by the Social Insurance Institution and transferred to the Open Pension Funds was 7.3 percent of the assessment basis, later, though, it was decreased to 2.3 percent and subsequently raised to 2.8 percent of the assessment basis (Article 21 of the amending act[10]). At that time the decline of the contribution raised reservations of a constitutional-legal nature[11]. The transfer of the contribution to the Open Pension Funds (determined in Article 22, subsection 3 of the Social Insurance System Act) takes place with the help of the Social Insurance Institution and the Social Insurance Fund, which, however, does not include this part of the contribution among its revenue (Article 51 of the Social Insurance System Act), and passes the amount to the Open Pension Funds.

c) The rules of the collection of funds by Open Pension Funds – the difference between the PAYG and funded part of the basic social security pension scheme, the rules of investing

The differences between two pillars were the cause of the changes implemented in 2011 and 2013. The Social Insurance Fund does not gather any real funds. We can say only about expectancy rights of the pension benefits to a level which is determined by the Social Insurance Institution on the individual accounts of the future pensioners, based on the paid contribution. The Social Insurance Institution manages bank accounts and subaccounts. The subaccounts were created in 2011 when the contributions transferred to the Open Pension Fund were brought down. The value of the assets repossessed from the Open Pension Fund is noted on the subaccount. The rights resulting from the subaccounts notations are indexed differently than the rights on the basic account. The indexation depends on the nominal GDP growth over the last 5 years and cannot be negative. By contrast, the indexation of the rights resulting from the notations on the individual

8. Article 22 of the Social Insurance System Act of 13 October 1998, Consolidated text, Journal of Laws (Dz. U.) 2009, no. 205, item 1585.
9. K. Wider Ślebzak , "Prawo do emerytury w systemie zdefiniowanej składki", *Konstrukcje prawa emerytalnego*, ed. T. Bińczycka-Majewska (Kraków: Zakamycze, 2004), 147–148;
10. The Act to amend certain acts related to the operation of the social insurance system of 25 March 2011, Journal of Laws (Dz. U.) No. 75, item 398.
11. R. Pacud, "Zmiana kierunku reformy emerytalnej z 1999", *PiP* 1 (2012), 17 et seq.

pension accounts depends on the level of employment and the average salary in the economy. Such a method of indexing the contributions scored on the individual accounts, seemingly saves the Social Insurance Institution from the financial effects of the demographic situation worsening. It subordinates the increase to the employment level. If it receded and the relation of those employed to pensioners worsened, the indexation of the contributions would be lower and, as a result, the Social Insurance Institution would spend less money on the pensions paid when the insured reach specific age. Nevertheless, presupposing the non-negative indexation may jeopardise the self-funding of the system when the pace of economic growth declines. The system may be ineffective in respect of the paid amounts and the amounts of the scored pension obligations. The real funds invested on the capital market are gathered in the personal accounts in the Open Pension Funds.

The Social Insurance Fund and the Open Pension Funds constitute separately functioning parts of the system. The parts complement each other and enable more effective security due to the scattering of risk. The scores on the individual accounts in the PAYG part of the basic pension scheme are very sensitive to demographic changes – the number of people employed, pensioners, the payroll budget growth rate. These are the determinants of the indexation of the contributions inventoried in the Social Insurance Fund accounts. The case is different when it comes to the funded part of the basic pension scheme. In the Open Pension Funds the account balance depends on the economic situation on the capital markets and on the general pension societies' management abilities. The fact that the risks resulting from the employment market situation and the risks of recessions on the capital markets usually appear in different periods is given as a factor neutralising the risks influencing the Social Insurance Fund and Open Pension Funds separately[12]. Such a solution should secure a higher pension from both of the pillars than from each one of them separately[13].

The amount of the units that every member has is inventoried on the account of the Open Pension Fund member, whereby the member becomes the fund's creditor and the liability's value depends on the current appraisal of the held participation units – this information is given to Open Pension Fund members. We can assume that an Open Pension Fund member becomes the fund's creditor both on account of the paid contributions and the achieved benefits, because the Open Pension Fund's means do not constitute direct property of members – this is due to the vesting of property rights to Open Pension Funds[14].

12. IGTE remarks to the draft Act amending the Act on the Social Insurance System and the Law on organisation and operation of open funds (Senate printed matter 1172).

13. A. Chłoń-Domińczak, "Wpływ sytuacji gospodarczej na system emerytalny", *Gospodarka i czynniki demograficzne a system emerytalny*, (Institute for Market Economics, 2010), 42.

14. K. Wider: see K. Antonów, "Emerytura z prywatnej części ubezpieczenia emerytalnego". *Ryzyko starości – problemy zabezpieczenia* (Kraków Polskie Stowarzyszenie Ubezpieczenia Społecznego (Polish Social Insurance Society), 2004), 88; A. Jabłoński, "Charakter prawny członkostwa w otwartym funduszu emerytalnym", *Konstrukcje prawa emerytalnego*, eds. T. Bińczycka-Majewska (Kraków: Zakamycze 2004), 191–192; R. Pacud, "Oczekiwanie prawne na emeryturę dożywotnią (ekspektatywa)" (Bydgoszcz-Katowice: Branta, 2006), 108–109; K. Ślebzak, "Prawo do emerytury w systemie zdefiniowanej składki", *Konstrukcje prawa emerytalnego*..., 147–148.

1.2. Reasons for the reversal of systemic pension reforms

a) Public law ("struggle" with increasing public debt and financing the current old-age pension)

It is impossible not to get the impression that in recent years the basic direction of the changes concerning the social security system is purely fiscal and comes down to improving the situation of public finances.

The Social Insurance Fund's difficult situation (its deficit was 51 billion PLN in 2013) was the direct reason of the actions undertaken. The Social Insurance Institution raised loans from the Treasury to cover the deficit and gain means to pay the pensions and annuities that were due. The Treasury – because of the lack of sufficient budget revenues – was compelled to incur a debt, particularly through government bond issues. Increasing the height of the contributions or decreasing the height of the retirement benefits would enable a reduction in the budget deficit. The first solution – hitting the entrepreneurs – would risk economic collapse. The second solution would violate the constitutional the rule of fairly acquired rights.

Such a situation would lead to an increase of the public debt to the dangerous level of 55 percent GDP[15]. Pursuant to Article 86 subsection 1(b) of the Public Finance Law[16] in such a situation the state budget for the next year must be balanced[17]. The impossibility of covering the deficit with the debt titles would oblige the authorities to raise taxes as the main budget revenue and also to curtail expenditure.

b) Private law

The legislator – looking for an explanation for the amended changes – claimed that the stock, being part of the assets, was jeopardised by risk on the financial market. The stock value keeps fluctuating, which means that not only can it increase but also decrease – as happened in 2007–2009. Often the profits made on the financial markets are of random character and their stability should not be considered as something certain[18]. The mandated changes concerning the rules by which the Open Pension Funds can invest assets, in the light of such an argumentation, seem surprising. Since 4 February 2014, Open Pension Funds have been obliged to allocate at least 75 percent of the assets in stock. On the other hand, since 1 July 2014 the investment limits (concerning the open fund's assets allocation) have been freed.

1.3. "Nationalisation" of the funded part of the basic pension scheme

a) The legal basis and the changes made

On 6 December 2013 the Sejm of the Republic of Poland enacted the Act to amend certain acts related to defining the rules of the pension pay-outs from the funds gathered in the open pension

15. According to Article 216, para. 5 of the Polish Constitution, it shall be neither permissible to contract loans nor provide guarantees and financial sureties which would engender a national public debt exceeding three-fifths of the value of the annual gross domestic product...".
16. Public Finance Law of 27 August 2009, consolidated text, Journal of Laws (Dz. U.) of 2013, item 885.
17. P. Pomorski, "Państwowy dług publiczny", *Ustawa o finansach publicznych. Komentarz. Supelement*, eds. P. Smoleń (Warsaw 2013), 15–17.
18. The rationale of the draft Act to amend certain acts related to defining the rules of the pension pay-outs from the funds gathered in the open pension funds (draft act of 12 November 2013), 5.

funds[19]. Some fundamental changes in the pension system were undertaken through this act: previously, Open Pension Funds' means were to be paid only to finance funded pensions; following the enactment, legal mechanisms have been created to pass the Open Pension Funds' means to the Social Insurance Fund, the Demographic Reserve Fund or the Treasury, and there is also machinery in place that curbs passing the contributions to an Open Pension Fund.

b) The financial consequences (for the state / government)

On 3 February 2014 the Open Pension Funds remitted 51.5 percent participation units noted on every Open Pension Fund member's account and transferred assets (such as government bonds and Bank Gospodarstwa Krajowego (National Economy Bank) bonds to finance highway construction) to the Social Insurance Institution which operates on behalf of, and for the benefit of, the Social Insurance Fund. Open Pension Funds passed 153 billion 150 million PLN to the Social Insurance Institution. They transferred 134 billion PLN worth of government bonds (€106 million), 17.2 billion in bonds guaranteed by the Treasury and 1.9 billion in cash. Accordingly, the national debt decreased by 130 billion PLN (the bonds are counted nominally). According to the EU definition,[20] this debt decline amounted to approximately 9 percent of the GDP.

Neither the Social Insurance Institution nor the Social Insurance Fund was enriched by these assets, although the global value of the pension obligations increased – 153,15 billion PLN – this will soon be covered by the insurance community with the help of the state. This is the amount of the Open Pension Funds' assets remitted in 2014.

a) Private law consequences for the insured

The increase of the Social Insurance Institution's liabilities (because of the exhaustion of the Open Pension Funds' assets) will be expressed by the total amount noted on the insured subaccounts. This amount will increase the pension expectancy rights from the Social Insurance Fund but without the cover from the Open Pension Funds. From the perspective of the insured, the debtor has changed. Currently, on the grounds of the membership agreement, it is the Open Pension Fund, later it will be the Social Insurance Institution, which will be connected with the insured through a public legal relationship.

Along with the contribution settlement for the period to 30 June 2014, passing the contributions to the Open Pension Fund ceased. Every insured person who wanted his/her contributions to be transferred to the open pension funds had to make a statement after being introduced to information concerning the public pension system and the members of the open pension funds. The obligation to take part in the open pension fund concerning the new contributions was abolished. Without making this statement, an insured member keeps his status at 48.5 percent of the assets gathered until 30 June 2014'. From 1 April to 31 July 2014 it was possible to reacquire the right to allocate the contributions

19. The Act to amend certain acts related to defining the rules of the pension pay-outs from the funds gathered in the open pension funds of 6 December 2013, Journal of Laws (Dz. U.) of 2013, item 1717.

20. The EU definition of public debt is a debt of the general government according to the European System of Accounts ESA 95, calculated uniformly in all European Union countries (including Poland). The EU methodology for calculating public debt stems from the Maastricht Treaty containing, inter alia, debt and deficit criterion and providing EDP (Excessive Deficit Procedure – EDP) in the case of non-compliance. More on the differences between the definition of EU public debt and the definition of domestic public debt see the Answer of the Undersecretary of State in the Ministry of Finance – the authority of the Minister – for interpellation 942 on standards for the calculation of the public debt of 1 October 2012.

in the Open Pension Fund. This was possible if the open pension fund member made statement – in compliance with the form – (either written or via an electronic document) about passing the contribution to the Open Pension Fund, beginning with the contribution paid for July 2014 (Article 11, subsection 2 of the Act on the amendment). From 2016, every four years, from 1 April to 31 July it will be possible to make a similar statement about passing the contribution to the open pension fund, beginning with the contribution paid for July. The statement can also constitute a withdrawal from membership when it comes to the new contributions and thus record them on the Social Insurance Fund subaccount (Article 39a, subsection 1 of the Social Insurance System Act, the so called "open window").

The change is not about bringing in the freedom of membership in the Open Pension Fund, because it is impossible to lose membership in the assets that were not remitted once on 31 July 2013; Open Pension Fund members were also not given the strictly understood right to make a transition to the Social Insurance Institution. By virtue of the Act all of the insured lose the right to pass the part of the contribution to the Open Pension Fund and can only recover it under strictly determined conditions. New rules concerning membership in the pay-as-you-go and capital part of the social insurance system are an effect of the expiration of the right to allocate part of the contribution after 31st July 2013 by law. In accordance with Article 22, subsection 3 of the Social Insurance System Act, part of the contribution (2.92 percent of the basis of assessment) is deducted by the Institution to the chosen (by the insured) open pension fund – this can happen only if he/she made a valid statement in time about transferring the new contributions to the Open Pension Fund. When it comes to these people, 4.38 percent of the basis of assessment is deducted by the Institution to a subaccount owned by the Social Insurance Institution. The whole 7.3 percent of the basis of assessment is deducted to a subaccount in the Social Insurance Institution for the people who did not fulfil the conditions prearranged in the Act, or for younger people who did not manage to make the membership agreement in the statutory terms.

The Act of 6 December 2013 abolished the annuities which were to be paid via the Lifetime Capital Pensions Funds. On the grounds of Article 9 of the Act, Article 10 of the Funded Pensions Act was abolished. It stated the conditions on which an open pension fund member acquired the right to the lifetime capital pensions and all of the provisions that regulate their payment. After living to a pension age – which is progressively rising from 1 January 2013 until reaching the target age of 67 – the insured will be entitled to only one pension from the Social Insurance Fund. Temporarily, before this time there are the Periodic Capital Pensions, financed partially by the Open Pension Fund and paid by the Social Insurance Institution. The Periodic Capital Pensions can be paid along with the so-called semi-retirement pensions. The members of the Open Pension Fund can no longer cover their own pensions with means from the Open Pension Fund; thus, the gathered assets serve only to improve the solvency of the Social Insurance Fund. Therefore, the proposal departs from the individualisation of financing the pensions and leans towards their being made common in the Social Insurance Fund.

Such a great change in the pension system also caused a change in the Open Pension Fund's operation aim, in place from 1999. Article 9 of the Act on the amendment changed the Open Pension Fund's operation aim, which, as the law stands, in accordance with Article 2, subsection 2 of the The change is then about removing the aim of committing the financial means to pay an Open Pension Fund member.

Open Pension Fund membership was time-limited and incoherent with the choice of the insured regarding the time of retirement. In the light of Article 22, subsections 3c and 3d of the Social Insurance System Act, the Social Insurance Institution ceased deducting contributions to the Open Pension Fund. This can happen from the day preceding the three-month period before the month during which the insured would live to the pension age (determined in Article 24 of the Act on the pensions and annuities from the Social Insurance Fund) or earlier – if the insured would acquire the pension before living to the statutory pension age. Moreover, the Social Insurance Institution inventories the contributions only on the subaccount if the insured acquires pension rights or semi-retirement rights and continuation of employment.

1.4. The current situation/prospects for the future

The old-age pension component of the c structure has not changed but the role of private funds has been marginalised. Even if we consider only this group of the Open Pension Fund members that decided to still partially contribute to the open funds, we cannot call this system on which their pension is based the "two-leg system". Both the changes undertaken in 2011 (cutting significantly the part of the contribution funnelled to the Open Pension Fund) and the fundamental changes implemented in 2013 have a great impact on it.

The Open Pension Fund was chosen by 2,564,072 people, which is 15,4 percent of all of the entitled to choose (that is 16,697,221 Open Pension Fund members at the end of May 2014). Such a result should be seen as a huge success of the private funds, considering the advertising prohibition and unfavourable (for the Open Pension Fund) arguments raised against passing the further means. Smaller Open Pension Funds may face difficulties, because they will almost certainly be consolidated[21].

The public debt decline as a result of the implemented changes does not solve the financial problems of the social insurance system – or it may even make it worse. The redeemed means diverted from the Open Pension Fund do not reduce the deepening deficit of the Social Insurance Fund. The pensionable obligations were increased by the amount of the redeemed assets. The lack of means to pay the pension benefits is a genuine threat. On the one hand, it may be caused by the low birth rate and low immigration rate; on the other hand, the cause may also be entering the pension age by the people that were part of the baby boom after World War 2 and also the increasing life expectancy[22]. The catastrophic state of the first pillar of the social insurance system can be demonstrated by noting the authorisation for the Minister of Finance to extend a loan to the Social Insurance Fund for paying the pension benefits guaranteed by the state (up to 18 billion PLN – Article 8 subsection 2(e) of the 2014 Budget Act[23]). This sum clearly exceeds the extent of the authorisations from the previous years. The inclusive Social Insurance Fund indebtedness was over 27 billion PLN (27,330,531,000 PLN)[24], whereby the Treasury's refund of the costs borne by the Social Insurance Fund while passing the assets to the Open Pension Fund was only 8 billion PLN (8,198,142,000 PLN)[25] in 2014.Taking two issues into account – firstly, the very high Social Insurance Fund deficit, and, secondly, the unfavourable demographic trends – the incorporated methods of passing the assets enlarge the possibility of decreasing the value of the pensions paid in the future. At the same time, it jeopardises the balance of the public finances in the mid- and long-term perspective[26].

21. See: G. Osiecki, "OFE uciekły spod gilotyny. Ponad milion złożonych deklaracji", *Gazeta Prawna* 30 (2014), accessible at http://serwisy.gazetaprawna.pl/emerytury-i-renty/artykuly/813063.
22. The press information entitled "Jak ZUS przejął środki z OFE?", Supreme Chamber of Control, 1 August 2014, available at http://www.nik.gov.pl.
23. The 2014 Budget Act of 24 January 2014, Journal of Laws (Dz. U.) 2014, item 162.
24. The 2014 Budget Act, attachment 13, Table 28.
25. As mentioned above.
26. D. Adamski, "Konstytucyjne konsekwencje najnowszych zmian w OFE", *FOR analysis* 10 (2014), 18.

2. The Hungarian perspective

2.1. **The principles of operation of private pensions before the reversal**

a) The place of private pensions in the social security system

In Hungary a multi-pillar system was created. The pillars are the following:

Table 2.

Number of pillar	Name of the retirement benefit	Legislation relating to retirement benefit.	Financing method	Participation
1st	Social security pension	Act LXXXI of 1997 on Social Security Pension	Pay As You Go	Mandatory
2nd	Private pension	Act LXXXII of 1997 on Private Pensions and Private Pension Funds	Funded	Mandatory until 03.11.2010
3rd	Voluntary private pension	Act XCVI of 1993 on Voluntary Mutual Insurance Funds	Funded	Voluntary
4th	Pre-retirement savings account (Nyugdíj-előtakarékossági számla)	Act CLVI of 2005 on Pre-Retirement-Savings Account	Funded	Voluntary
5th	Occupational pension scheme	Act CXVII of 2007. on Occupational Pension and the Related Institutions	Funded	Voluntary
6th	Products of private insurances	Act V. of 2013 on the Civil Code Act LX of 2003 on Insurance Institutions and the Insurance Business	Funded	Voluntary

Source: authors' own elaboration[27].

The first pillar is the state-run, social security pension pillar; the second is the private pension fund system[28], the third is the voluntary private pension fund system. The voluntary private pension fund system is also divided into four more pillars: a) supplementary private pension funds, b) the pre-retirement saving account (*nyugdíj-előtakarékossági számla*); c) the occupational pension scheme, d) products of private insurance.[29]

So until the end of 2010, the mandatory pension system was a two-pillar system (the first pillar was the social security pension system, and the second pillar was the private pension fund system).

The two different pillars of the pension system would have ensured pension services in the future as three-quarters of the pensions of those choosing the mixed system would have been paid from the first pillar and the remaining quarter would have been provided for from the second pillar.[30]

27. The literature distinguishes several types of classification because of the different financing structure.

28. There are two types of the private pension funds: open-end funds and closed-end funds. The open-end fund is a fund which does not restrict the scope of potential fund members with the exception of determining the territorial scope of territorial funds. The closed-end fund is a fund which restricts the scope of potential fund members on the basis of professional or other organisational principles. Based on Act LXXXII of 1997. Section 2.

29. J. Hajdú, "Hungarian pension system in transition", *Studia Iuridica Caroliensia* 6 (2011), 45.

30. J. Hajdú, "Hungarian pension system in transition", *Studia Iuridica Caroliensia* 6 (2011), 45–47 and based on Act LXXII of 1997.

b) The distribution of contributions between the first and second pillar

Coverage of social insurance pensions takes place through the contribution of employers and employees. The state undertakes that the retirement benefits are paid even if the expenses of the Pension Insurance Fund exceed receipts. If the anticipated expenses of the Pension Insurance Fund exceed receipts, the difference shall be secured from the central budget allocation. This is the state guarantee principle.[31]

Private pension fund members[32] paid membership fees to the fund and pension contributions to the social security system. The membership fee was based on the member's taxable income, its actual rate was determined by law. The private pension fund members had to pay 6 percent of their taxable income to private pension funds in 1998, 7 percent in 1999 and 8 percent in 2000. The membership fees paid by the members were transferred to their individual accounts.[33] They also had to pay a reduced contribution of 1 percent to the state pension fund in 1998. In 1999, 2000 and 2011 this contribution was 2 percent. Employers had to pay a pension contribution to the PAYG pension scheme. This contribution was 24 percent in 1998, 22 percent in 1999 and 2000, and 24 percent in 2011.

The payments were invested by the fund, and old-age pensions were supposed to be provided through the use of this accumulated amount. The accumulated capital on the individual account could be inherited, the payments from an insured person who died during the accumulation period were awarded to beneficiaries who could take the amount out in the form of lump sum, or they could continue their membership in the pension fund.[34]

During the accumulation period, the fund members form an investment risk community, and in the benefit period they form an investment and insurance risk community. In accordance with the principle of ownership, the claim of the fund member is the fund member's property and may be inherited.[35]

b) Private law (the condition of private pensions?)

The guarantee and prudent management of the portfolio private pension funds represented significant risks, and the financial crisis in 2008 demonstrated this. So the international financial and economic crisis has highlighted the transition costs of the funded principle.

31. Act LXXXI of 1997. Section 2. (2) and József Hajdú, "The Hungarian Old-age Pension System in the Early 21st Century" in Kristina Koldinská, *Reflections on 20 Years of Social Reform in Central and Eastern Europe*, (Prague: Auditorium, 2010), 182–183.
32. Fund member: any natural person who, on a mandatory or vountary basis, becomes a fund member, pays a membership fee pursuant to the provisions, and receives pension plan benefits from the fund (Act LXXXII of 1997. Section 4. (2) c).
33. Individual account: record of contributions, on the basis of which the fund member's claim during the accumulation period and the fund member's pension plan benefits at the time of retirement shall be calculated.
34. J. Barta, "The role and function of the pay-as-you-earn pension system in the Hungarian pension system", *European Integration Studies* 9/1 (2011), 8–10.
35. Act LXXII of 1997. Section 5 (3).

2.2. "Nationalisation" of the second pillar

a) the legal basis

The objective of the pension reform in Hungary was to return, from the (in the narrow sense) three-pillar system, to the two-pillar pension system, based on social solidarity, on the one hand, and voluntary contributions on the other hand.[36] The Hungarian government is committed to maintaining and supporting voluntary private pension funds parallel to the state-run, compulsory social security pension pillar.

b) the changes made

From 3 November 2010 the entrance to the private pension funds was no longer required for new entrants to the labour force.

Around 3.2 million fund members were given the chance to return to the social security pension system. By 31 January 2011 the private pension fund members had to declare if they wished to maintain their membership in the private pension funds.

Those who failed to make a declaration automatically entered into the first pillar and they lost their private pension fund membership. It is important to note that in this case the cessation date of private pension fund membership was 1 March 2011.

Apart from 97,500 members, everyone opted back to the first pillar state pension system for better benefits. Only 3 percent of the full members decided to stay in the second pillar pension scheme.[37] As a result, the participation in the second pillar would no longer be compulsory.

Those private pension fund members who retired before 1 February 2011 still had the possibility to opt back to first pillar system. They could request the amended amount of the retirement benefits by 31 January 2011, as if they had gone to the Social Security retirement pension system. Thus, the full state retirement pension would have been entitled. The condition was that the amount of the previously used benefits of private pension funds had to be paid back by the fund member for the pension fund. The pension fund transferred this amount to the first pillar.

From 1 November 2011 the private pension fund members who chose the second pillar did not acquire contribution years and average salary, which was the condition of eligibility for state retirement benefits in the first pillar. The legislation imposes firm penalties upon Hungarian pension fund members who did not transfer their pension assets back into the state system by the end of January 2011.[38] Those who wanted to retain their pre-funded accounts would not be eligible for partial PAYG in the future, even though they have contributed to the current generation of pensioners' benefits; and those who wanted to keep their entitlement to a first-tier pension must "volunteer" to give their savings in the second pillar to the government in exchange for maintaining their stake in PAYG schemes.

The private pension fund membership fee was diverted to the first pillar for 14 months and the necessary compensation, due to this fact, was only partially accomplished.[39] Due to the redirection of the mem-

36. Based on 1281/2010. kormányhatározat (government decision) 1st point.

37. The source of data: http://felugyelet.mnb.hu/bal_menu/jelentesek_statisztikak/gyorselemzesek/penztarak.

38. Based on Act C of 2010.

39. Act CI of 2010. Section 1. and 2. and D. R. Lados, "Mérlegen a magánnyugdíjpénztári rendszer működése Magyarországon" in T. Székely (szerk.), *XII. Rodosz Konferenciakötet, Társadalomtudományok* 2. kötet (Rodosz-Editura Marineasa, Kolozsvár-Temesvár, 2011), 40–47.

bership fee there was a definite formula to determine the control of supply for the social security pension fund members. However, this compensation, using the formula, was only carried out for those fund members who acquired the membership entitlement to the social security pension benefit by 31 October 2011.

The operation costs of private pension funds were based on the cost of the public pension system operation, despite the fact that the two pillars' financing and operation method/costs are different. The cost of private pension funds and the trading costs of the investments may be subject to only 0.2 percent.[40] Previously this was 0.8 percent.

The private pension fund members could not rely on a state guarantee. According to the previous legislation, the state should secure the operation of the private pension system by enforcing the rules of institutional protection, by maintaining state supervision and by assuming financial guarantees from the central budget for the liquidity of the Guarantee Fund, which guarantee the payment of the fund members' claims[41]. This legislation was in force until 21 December 2010. Regardless of this, the private pension funds which have an operational licence shall join the Guarantee Fund and pay a guarantee fee to the Guarantee Fund. The responsibility of the Guarantee Fund is to effect the payments.[42]

b) The distribution of contributions between the first and second pillar

Coverage of social insurance pensions takes place through the contribution of employers and employees. The state undertakes that the retirement benefits are paid even if the expenses of the Pension Insurance Fund exceed receipts. If the anticipated expenses of the Pension Insurance Fund exceed receipts, the difference shall be secured from the central budget allocation. This is the state guarantee principle.[43]

Private pension fund members[44] paid membership fees to the fund and pension contributions to the social security system. The membership fee was based on the member's taxable income, its actual rate was determined by law. The private pension fund members had to pay 6 percent of their taxable income to private pension funds in 1998, 7 percent in 1999 and 8 percent in 2000. The membership fees paid by the members were transferred to their individual accounts.[45] They also had to pay a reduced contribution of 1 percent to the state pension fund in 1998. In 1999, 2000 and 2011 this contribution was 2 percent. Employers had to pay a pension contribution to the PAYG pension scheme. This contribution was 24 percent in 1998, 22 percent in 1999 and 2000, and 24 percent in 2011.

The payments were invested by the fund, and old-age pensions were supposed to be provided through the use of this accumulated amount. The accumulated capital on the individual account could be inherited, the payments from an insured person who died during the accumulation period

40. Act CLIV of 2010. Section 19. and 20.

41. Act LXXXII of 1997. Section 100.

42. Act LXXXII of 1997. Secton 86. and 88.

43. Act LXXXI of 1997. Section 2. (2) and József Hajdú, "The Hungarian Old-age Pension System in the Early 21st Century" in Kristina Koldinská, *Reflections on 20 Years of Social Reform in Central and Eastern Europe*, (Prague: Auditorium, 2010), 182–183.

44. Fund member: any natural person who, on a mandatory or vountary basis, becomes a fund member, pays a membership fee pursuant to the provisions, and receives pension plan benefits from the fund (Act LXXXII of 1997. Section 4. (2) c).

45. Individual account: record of contributions, on the basis of which the fund member's claim during the accumulation period and the fund member's pension plan benefits at the time of retirement shall be calculated.

were awarded to beneficiaries who could take the amount out in the form of lump sum, or they could continue their membership in the pension fund.[46]

During the accumulation period, the fund members form an investment risk community, and in the benefit period they form an investment and insurance risk community. In accordance with the principle of ownership, the claim of the fund member is the fund member's property and may be inherited.[47]

c) The rules of the collection of funds by private pensions (the difference between the first and the second pillar, the rules of investing)

The first pillar operates by the PAYG (pay-as-you-go) principle. The first pillar has the aim of revenue maintenance through benefits consistent with the PAYG mechanism and defined-benefit logic (social contributions are not saved but used to pay current pensions). The PAYG Pension systems pay pensions out of current contributions or taxes. They are usually run by governments from current tax revenues, and the amounts of the benefits are based on commitments or promises, made by governments. In the case of a defined contribution plan, the contribution rate is fixed. The individual's pension is an annuity whose size – at a given life expectancy and rate of interest – is determined only by the size of his or her lifetime pension accumulation.[48] Members of these schemes face the uncertainties associated with varying real rates of return on the pension assets.

The second pillar operates by the fully-funded method of financing. Membership fees are collected and managed by private pension funds. These funds pay benefits as well. There is no direct guarantee in the second pillar. If a private pension fund is not able to provide a member with benefits, the receivable account is frozen and the missing amount must be paid by the Guarantee Fund[49]. There are a number of indirect guarantees within the system: supervising the funds, creating reserves, legislative measures for the management, and so on.[50]

3. The reasons for reversal of systemic pension reforms

a) Public law ("struggle" with the increasing public debt, raising funds for the current payment of pensions)

The demographic projections imply that the pension costs will increase and thereby constitute a strain on the government budget. The financial crisis has further aggravated this situation. An increasing dependency ratio will put a strain on the government budget in the sense that it will require relatively more to make ends meet in the future than today. For all EU Member States, on average, pension expenditure amounts to 10.2 percent of GDP. Member states such as Hungary or Poland have higher shares of pension expenditure than the average level. Old-age pensions and early pensions are the most important items among the pension expenditure, and disability pen-

46. J. Barta, "The role and function of the pay-as-you-earn pension system in the Hungarian pension system", *European Integration Studies* 9/1 (2011), 8–10.
47. Act LXXII of 1997. Section 5 (3).
48. N. Barr, „The Pension Puzzle, Prerequisites and Policy Choices in Pension Design", accessible at http://www.imf.org/external/pubs/FT/issues/issues29/index.htm.
49. The minimum pension payment to be disbursed to any fund member, the funding of which shall, at the time of the pension calculation, be guaranteed by the Guarantee Fund (Act LXXII of 1997. Section 1.).
50. J. Hajdú, "The Hungarian Old-age Pension System in the Early 21st Century" in Kristina Koldinská, *Reflections on 20 Years of Social Reform in Central and Eastern Europe* (Prague: Auditorium, 2010), 185–187.

sions and survivor pensions only play a minor role. To the extent retirees have to pay taxes from the public pension, the net public pension expenditure is lower.[51]

In August 2010, together with seven other EU countries, Hungary and Poland asked the EU to take into full account the transition costs of pension privatisation in the budget deficit and government debt. The rapid EU decision was a conditional "yes" and "no": yes for Poland, with a lower government debt ratio, and no for Hungary, with a higher government debt ratio.[52]

In Hungary the first key problem is that, due to the modifications of the Hungarian pension system, the financing of the state pension pillar has became questionable. Part of the pension contributions was channelled into the second pillar, leaving a financing gap in the first pillar. As long as only a portion of the retirees receive a certain part of their pension benefits from the private pension fund savings accumulated in their active years, pension liabilities put increased pressure on the state budget. In 2011, state budget revenues of the first pillar of only 2100bn HUF stand against the benefit payment of over 3000bn HUF. So in 2011 the state-run pension system would incur a deficit of 900bn HUF. Another problem of the Hungarian pension system is that there are both solidarity and social care type obligations in the first pillar (related to old age pension liabilities and social aspects of disability allowance and early retirement benefits). The third problem is the insufficient incentives for voluntary pension savings, resulting in sub-optimal accumulation of long-term savings in the voluntary private pension funds. The fourth problem is the fact that there is a shortage of one million legally employed workers paying pension contributions in the short or medium term, and one million children who could make the system sustainable in the long run.[53]

The matter became the subject of a settlement of the European Court of Human Rights. The case of E.B. vs. Hungary concerned changes to the Hungarian pension system in 2010 via new laws and the statement that the new legislation effectively amounted to confiscating private pension contributions for the benefit of the state. Ms E.B. complained that the new legislation of the private pension scheme effectively amounted to confiscating her private pension fees to the benefit of the state budget. She alleged in particular that, even if she was entitled to a full state pension under the new legislation, this fell short of a private pension scheme which was directly related to her contributions and investment strategy. She also complained that, as she intended to work abroad, it was not for certain that she would accumulate enough years of service to be entitled to a state pension. The Court observed that Ms E.B.'s fees to the private funds before 1 November 2010 remained intact under the new legislation, and that the ones made afterwards were transformed into an entitlement under the state scheme. Similarly, her contribution years were recognised in the periods both before and after the change in legislation. Any speculation as to accumulating contribution years domestically or abroad was, for the Court, immaterial. Quite besides the fact that the situation resulted from Ms E.B.'s own choice, she was in any case entitled to future pension payments through the contributions she had made during the entire period of her employment either to the private

51. EP, Directorate-General for Internal Policies, Pension systems in the EU-contingent liabilities and assets in the public and private sector, ECON, 2011.

52. A. Simonovits, "The Mandatory Private Pension Pillar In Hungary: An Obituary" (Institute of Economics, Hungarian Academy of Sciences, 2011), 15.

53. Ministry for National Economy, The reform of the Hungarian pension system (a reformed reform), accessible at http://www.mfa.gov.hu/NR/rdonlyres/97A1F1F0–92D7–42AE-A8AD-49A260C81066/0/Thereformofthe-Hungarianpensionsystem.pdf.

pension fund or the state fund. There had therefore been no interference with her property rights, including her legitimate expectation to receive a pension in the future.[54]

c) The financial consequences (for the state / government)

Of the HUF 2945 billion (USD 15 billion) appropriated from private pension funds in 2011, only HUF 200 million (USD 890,000) remained at the end of 2013. While most of the money was used to pay the debt down, some was also used to plug spending gaps in the state budget. None of the money appears to have been spent on the state pension reform. In 2013 the government spent HUF 315.8 billion (USD 1.5 billion) from the "Pension Reform and Debt Reduction Fund". The fund's largest single expenditure took place in July, when the national government spent HUF 81.3 billion (USD 370 million) to pay the debts of local governments.[55]

d) Private law consequences for the insured

The following rights of the members remain unchanged.

The fund members shall have the equal rights and responsibilities. The fund members shall have the right to 1) participate in electing bodies of the fund, 2) be elected as members or officers of the fund's bodies 3) be regularly informed regarding the operation and financial management of the fund, as well as the balance of their accounts, 4) receive fund pension plan benefits.

The fund members may designate a beneficiary who is eligible for his/her individual account and pension plan benefit in the event of the death of the fund member. If the fund member fails to designate a beneficiary, the member's legal heir, a natural person, shall be regarded as the beneficiary.

4. The current situation/prospects for the future

a) The structure of the social security system

The key question is whether the private pension insurance exists to replace or supplement the public social security system. After the latest reform we can summarise: the private pension system has a replacement function. The structure of the social security system is the same as that previously presented. The role of the second pillar (private pension funds) changed. Due to the regulation, the role of the private pension funds was significantly marginalised.

b) The collection of contributions and payment of pensions insured who stayed in private pensions/prospects for the future

Due to the small number of members and the lack of acceptable legislation, the long-term survival of the private pension fund is questionable.

If the private pension fund system keeps its position, its comprehensive reregulation will become inevitable. The institutional and organisational structure is not adequate.[56] This regulation must be quick.

54. http://hudoc.echr.coe.int/webservices/content/pdf/003–4240871–5045019.
55. http://budapestbeacon.com/public-policy/hungarian-government-uses-private-pension-fund-proceeds-to-plug-spending-gaps/.
56. J. Barta, "The role and function of the pay-as-you-earn pension system in the Hungarian pension system", *European Integration Studies* 9/1 (2011), 14–15.

Hungary's remaining mandatory private pension funds could be eliminated by the end of this year if a new government measure that requires highly active membership is passed.

The latest legislation is aimed at closing down private pension funds and quasi nationalising their total funds of about 200 billion forints to (i) reduce public debt and (ii) keep the budget deficit below the 3 percent EU threshold and (iii) avoid the reopening of the EU's excessive deficit procedure against the country. According to the plan, the private pension schemes must show at least 70 percent of members have been paying monthly fees in the past six months or it must close down. The law could take effect on 1 January. Only about 10 percent of members pay a monthly fee to mandatory private pension funds. A survey has shown that 95 percent of fund members who opted to keep their mandatory private accounts were happy with that decision and would not opt back into the state system. These people are automatically forced back into the social security system and their wealth is transferred to the state budget. The four operating mandatory funds had about 200 billion forints in assets which could now go to the state.[57]

c) The collection of premiums and payment of pensions to those insured who are only in the first pillar

The Hungarian government claims that the pension system "has been saved" and has become sustainable, though experts say this is far from the truth. An OECD directive that is also accepted by the EU declared that citizens of Member States need to receive at least 70 percent of the respective country's average earnings as their pensions in order to have adequate sustenance when they retire. It is accepted that a solely state-run pension system will not be able to cover the gap.[58] The government believes that the solution is self-care in the field of pension insurance.

The Fundamental Law of Hungary declares: "Hungary shall contribute to ensuring the livelihood for the elderly by maintaining a general state pension system based on social solidarity and by allowing for the operation of voluntarily established social institutions".[59]

The Hungarian government is reported to be looking at converting the pension system into a national defined contribution (NDC) plan similar to Sweden's. In this way, personal accounts would be pooled for investment purposes, and benefits would accrue according to workers' contributions and the rate of return on the account. Upon retirement, each worker's account balance would be automatically converted to an annuity that would tie the benefit to shifts in life expectancy.[60]

Conclusions

Poland and Hungary had mandatory private pension schemes. These second pillars operate by a fully-funded method of financing (this means contributions are collected and managed by private pension funds), and this left a financing gap in the first social security pension pillar. Hungary and Poland have higher shares of pension expenditures than the average level. The lack of sufficient pension contributions led to an increase of the public debt to a dangerous level. So the direct

57. http://www.swissinfo.ch/eng/reuters/government-caveat-threatens-hungary-s-private-pension-schemes--fund-operator/41132922 and m.portfolio.hu/en/cikkek.tdp?k=2&i=28751.
58. http://www.bbj.hu/economy/real-yields-of-pension-funds-to-be-received-in-the-mail_59160.
59. Fundamental Law, Article XIX (4).
60. http://peoplespension.infoshop.org/blogs-mu/2010/06/21/hungary-template-for-social-securitys-future/.

reason for the Polish and the Hungarian changes are purely fiscal and come down to improving the situation of public finances.

Additional common features in both countries are that the legislators, looking for an explanation for the amended changes, claimed that the stock, being part of the assets, was jeopardised by the finance market risk.

More than 2.56 million Polish workers opted to continue saving for retirement partly through private pension funds. At first in Hungary only 3 percent of workers chose the second pillar, and after that the number of members of this pillar decreased. Both in Poland and Hungary the institutional and organisational structure is not adequate, so the long-term survival of the private pension funds is questionable.

In the Polish system, in contrast to the Hungarian one, it is difficult to talk about losing the mandatory character of the second pillar in relation to previous members. Despite the remission of 51.5 percent of the gathered units, the rest of the assets (of all the Open Pension Fund members) remained on accounts managed by private funds.

Another difference is the way of investing assets by pension funds. These arrangements are still the same in Hungary, but in Poland there was a change. In Hungary, there is no limit to the investment in government bonds, but there is a limit of 10 percent on Hungarian corporate bonds, 10 percent on Hungarian municipality bonds and 25 percent on mortgage bonds. This was also the case for the Open Pension Funds in Poland at the end of 2013, but this move was inverted in 2014, where treasury bonds and state-backed bonds are no longer allowed in the portfolios of these funds[61]. Strengthening the capital nature of the fund is not accompanied by maintaining financial strength and market position, which is dependent on proceeds from the contributions. Changes concerning assets and contributions have an impact on the dispersion of risk and consequently on financial security.

The final conclusion is that in Hungary and Poland the social insurance system structure has not changed but the role of the private pension funds has been marginalised.

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61. Annual Survey of Investment Regulation of Pension Funds, OECD, 2014, accessible at http://www.oecd.org/daf/fin/private pensions/2014_Survey_Investment%20Regulations.pdf.

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Reformy emerytalne w Polsce i na Węgrzech z perspektywy prawnej – podobieństwa i różnice

W sytuacji postępującej integracji gospodarek i społeczeństw państw członkowskich, sukcesy i porażki polityki emerytalnej i refom emerytalnych w poszczególnych krajach wywołują coraz silniejsze reperkusje poza ich granicami. Niniejszy artykuł stanowi próbę porównania rozwiązań prawnych zastosowanych Polsce i na Węgrzech, i ich skutków dla systemów emerytalnych obu krajów. Oba państwa mają podobną historię i zbliżone doświadczenia. Daleko idące podobieństwa widoczne zarówno w procesie reformowania systemu publicznego, jak i odchodzenia od reform, stały się pretekstem do przeprowadzenia wspomnianego porównania. Uzyskane wyniki są efektem zastosowania przez autorów analizy normatywnej. Węgry i Polska mają wyższy niż przeciętny udział wydatków emerytalnych. Niedobór składek emerytalnych doprowadził do wzrostu zadłużenia publicznego do niepokojąco wysokiego poziomu. Bezpośrednie przyczyny zmian wprowadzonych w Polsce i na Węgrzech mają zatem charakter fiskalny i sprowadzają się do konieczności poprawy sytuacji finansów publicznych.

Słowa kluczowe: system emerytalny, ubezpieczenia społeczne, fundusze emerytalne, system repartycyjny.

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