Large-Scale Transformation of Socio-Economic Institutions - Comparative Case Studies on CEECs

Background Paper 2: Comparative Country Study - Hungary

Working Paper no 18

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Abstract

The general idea is to follow the Varieties-of-Capitalism literature on generating indicators on the economic systems actually implemented. However, this literature mostly concentrates on the enterprise (or micro) level in traditional OECD countries, categorizing countries between the extremes: liberal market economies and controlled market economies. It largely neglects the role of the government spending, the transition of former socialist countries and developing countries, and the political process behind the choice of an economic system.

We broaden the perspective by combining the Varieties-of-Capitalism with the Worlds-of-Welfare-States literature in order to provide a comprehensive view on government activities in transition. With the perspective of our contribution to WWWforEurope, we concentrate especially on social welfare, innovation systems, macro stability, and, of course, how these aspects work together (or not) and are explained by the political background.

We will a cluster analysis for OECD and European transition countries and comparative country studies on Slovakia and Hungary. These countries are of special relevance because they represent extreme cases (Slovakia: significant switch in transition path towards star performer, Hungary: muddling towards problem case). One part of the comparative work concentrates on the comparison of Slovakia with other new EU members that also face to challenge of state building after dissolution of one or the other sort (Czech Rep. and the Baltics). The other part of the comparative work concentrates on Hungary in comparison with the other EU-CEECs. A broad based comparison will most likely be possible on available data only. The possibility for deeper qualitative comparisons will have to be determined during the project. The comparative components will focus on the macroeconomic background (Slovakia) and the welfare state (Hungary) respectively.

Cluster analysis (initially forseen for MS25) and comparative country studies allows us to draw conclusions for the EU by providing a first comparison of the position of CEECs with respect to the “old” EU members, most interestingly the southern crisis countries that are often categorized into a form called mixed market economies with sometimes contradicting institutional set ups. Do CEECs converge towards prototype models or do they (still) constitute own models?

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Contribution to the Project

Lessons from CEECs seem to be highly relevant for the transition of the EU towards 2020 goals because of the most profound and ambitious transfer of institutions in recent history which took place in these countries at different speed. Concerning the economic and especially the welfare system, the literature on varieties of capitalism has established two prototypes of capitalism – (LME) and Coordinated Market Economies (CME), a categorization that already divides EU-15 in two groups (anglo-saxon vs. continental). MS23 provides a first set of lessons based on comparative country studies by asking if CEECs are converging towards prototypes of capitalistic systems or rather establish new types of capitalism.

Keywords: EU integration, innovation, innovation policy, institutional reforms, macroeconomic disequilibria, market economy with adjectives, social development, welfare reform, welfare state

Jel codes: P10, P51

Introduction

The study focuses on the welfare state, the most important systemic element of capitalist models according to Sapir (2006).[1] Research on the services of the welfare state may provide deep insight into capitalist models especially if it is done in this broader sense. For such a survey provides valuable systemic information not only on the levels of social cohesion and fiscal discipline (the efficacy and sustainability of the system, see Sapir, 2006), but also on how social institutions work and on the relationship of polity and economy. In this regard the analysis of the history of the past 30 years of Hungarian welfare system also clearly shows the weaknesses of social-economic institutions, the ongoing presence of state paternalism and the continuous shuttling of polity between two poles: the more authoritarian, Eastern type of capitalism, and the more democratic and controlled Western type.

The formation and development of the welfare state among Central Eastern European countries (CEEC) has brought much attention. The collapse of the communist regime was followed by rapid and radical changes, institutions of parliamentary democracy have emerged and produced laws to harmonize with the new system, at the end a market-conform legal infrastructure has been installed. While rapid development of the private sector can be observed, the reform of the pension system, medical care and social assistance systems has been laid aside for several years (Kornai, 1997).

However, there are studies claiming that the post-socialist welfare state does not follow a single pattern, Deacon (1992), for instance, has predicted that Eastern European countries will develop their social policies in the future into distinct regimes that may even lie outside the three worlds of welfare capitalism described by Esping-Andersen (1990). The question of whether or not a specific CEEC model exists has been on the agenda for a long time. The transformation of the post-communist welfare states involves communist legacies and strong elements of path-dependency as well as innovations and path-departing changes (Cook, 2010). In this paper we analyse the Hungarian welfare state with the aim of pursuing a fertile ground for future research that encapsulates the existence and homogeneity (or heterogeneity) of the CEEC model.

If we look at the budgetary development of Hungary after the regime change, one can conclude that increased fluctuations in the fiscal balance may be a direct consequence of pro-cyclical fiscal policy interspersed with electoral budgets (i.e. deficits and debt-to-GDP ratios were always higher in time of elections). The existence of the fiscal cycles per se shows that the sustainability of the welfare state

[1] This research paper is strongly related to and in accordance with the paper by Miklós Szanyi: Varieties of capitalism in Central and Eastern Europe. A theoretical framework for analysis (forthcoming).

played a second fiddle role, and the necessity for structural reforms was therefore highly neglected (Muraközy, 2008). Let us underscore that the Hungarian welfare state is often characterised by the term 'premature' welfare state, coined by Kornai (1993, 1997) by calling the attention to the fact that the socialist regime did not leave behind a mature, but a system with significant distortions. If for no other reason than the transformation promised even more in terms of welfare services without mainly any rationalisation process in reining citizens' expectations (Muraközy, 2008:156). Related to this, as Szalai (2007) emphasised, fundamental changes in the institutional aspects of welfare services remained merely at the declaration of goodwill (i.e. the management and control system as well as the ownership structure remained unchanged, an apparatus responsible for the principle of accountability was not established intensively, and the hierarchical management system remained almost unattained). On the other hand, the transition brought to life a series of changes (e.g. perceptible changes were registrable in the daily roles and tasks expected from service provisions, and in the interest and power relationships as well. The core problem of Hungary's welfare system was that obviously a Nordic style welfare state was incompatible with the productivity level of any transition countries (Csaba, 1995). The question is how welfare institutions can be changed, however the generosity of the welfare state in Hungary has been cut back during the 1990s, and the initial distortions still have significant effects.

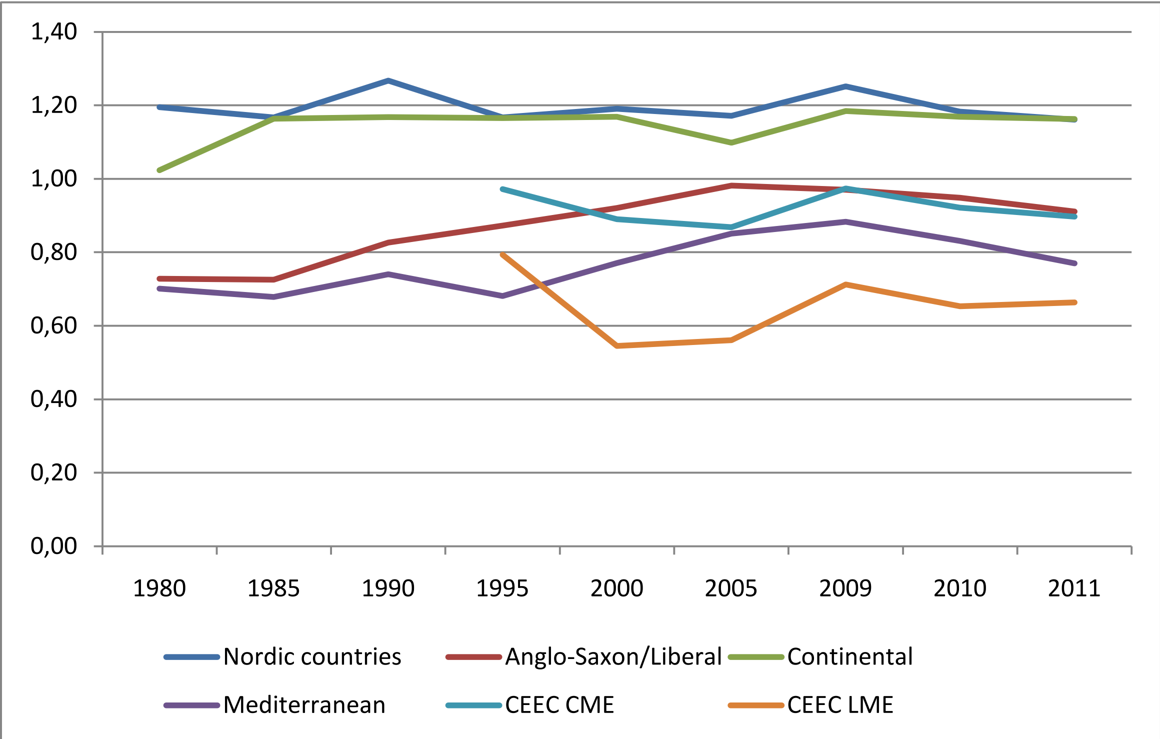
1. Analysis of welfare state generosity of the different models

Welfare generosity ratio is a simplistic measuring rod for assessing how well modern welfare states cope with the self-contradiction that while providing services they are generating at the same time increased demand for them. Two categories are mostly cited in the literature as most important factors affecting the welfare state, namely the aging population and the increasing level of unemployment (equal together the dependent ratio of the population). Based on the method of dividing the aggregates of social expenditures by the percentage of dependent population (population aged sixty-five and over and registered unemployed people) a simple ratio can be computed, measuring the generosity of welfare.[2] Theoretically it can be interpreted as the percentage of GDP received in welfare spending for every 1 per cent of the population in need (Castles, 2004:36). Welfare state generosity ratios put Hungary and the CEEC region on the map of the worlds of welfare states and allows us to compare welfare state policies of the country groups.

[2] However the described method is a really simplistic way to measure the performance of the welfare state by neglecting several other important factors, general trends can be drawn to compare different models. Country groups are created based on Sapir (2006) and the cluster analysis conducted by Schweickert (2013). Methodology based on Castles (2004) pp. 37, Table 2.4.

Analysing the result for the different models (*Annex 1*) it can be concluded that the generosity ratio of them all have converged (*Firgure 1*). By 2010 the Continental and the Nordic model have reached the same generosity level, meaning a significant cut and a salient increase respectively. The mean value of generosity for the Nordic countries went through significant decrease because Sweden and Norway radically cut back these types of expenditures, while for other Nordic countries this ratio has been increased. Coefficient variation of the Nordic generosity level is around 6 per cent compared to the overall 20 per cent value, generosity level in the Nordic countries is almost identical for 2011. Since 2009, the Continental CEECs converging towards the Continental countries and the Liberal countries show similar generosity trends, slightly below 1.0, while the Mediterranean countries after significant improvement (as a consequence of the EU accession) started to cut back welfare expenditures enforced by the crisis. Liberal CEECs countries have the lowest level of generosity and the reduction of generosity was the most radical among them between 1995 and 2000, however afterwards they have started to increase generosity again.

Figure 1. Welfare state generosity ratios for different welfare state models



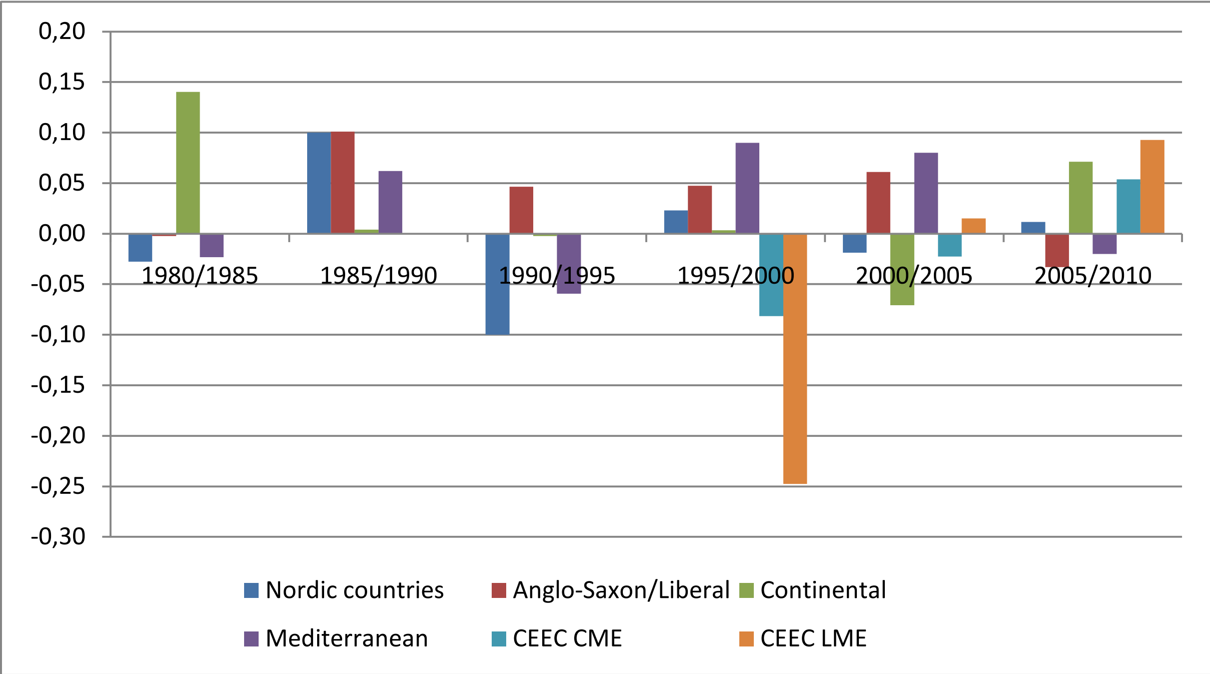
Source: own calculation based on OECD SOCX dataset and World Bank data, for detailed methodology description see Castles (2004) pp. 37, Table 2.4.

It is surprising that, since the 1990s, the coefficient variation has become significantly lower for all groups, except the CEECs. It can be understood as CEECs implement different policies in tackling the current crisis, while the other groups seem to be resistant to the crisis in perspective of the welfare

state reforms. Among Continental CEECs, Hungary has reduced its generosity level to the greatest extent, having the lowest level within its group in 2011. The level of social protection has been still in sharp contradiction with the general level of development, resulted in too generous welfare system at the time of the transition and afterwards. In order to solve the above mentioned mismatch as a consequence of the inherited premature nature of the Hungarian welfare state, radical welfare reforms are needed.

Looking more closely into the specific features of the Hungarian welfare system exhibits a large extent of path-dependency with the period before transition providing the background and the most recent years (2011 -) being characterized by proposals rather than implementations.

Figure 2. Welfare state generosity ratios differences for the welfare state models (5-year



Note: no data for CEEC CME and CEEC LME before the 1995 period.
Source: own calculation based on OECD SOCX dataset and World Bank data.

To understand the differences in case of generosity trends it needs to be investigated what factors operate behind. The different impacts of low expenditures versus high share of the dependent population have to be analysed on a more detailed way in order to establish a more comprehensive picture of the different models.

2. Economic transition in Hungary focusing on the welfare system and institutional change[3]

From the point of view of the welfare state, transition is not yet completed. A fundamental feature of transition is its destructive nature (Csaba, 1990, 1994) and the time horizon for transition was underestimated for the CEECs. While the institutional setup is compatible with market economies despite structural dissimilarities, the current crisis is an indicator of the incompleteness of institutional and regulatory change. Welfare systems in general and pension systems in particular are far from being sustainable (Csaba, 2011). The answers and solutions may differ from country to country; afterwards we will focus on Hungary. There have been several policy proposals to reform the welfare state itself, but the framework of their operation is still not finished yet. In our analysis we would like to highlight the specific features of the development of the Hungarian welfare state.

In case of Hungary path-dependency means that whatever change of the system took place, the country's historical experiences are inseparable from the evolved model of the 'Hungarian' capitalism. The processes of transition are fundamentally defined by the previous reform initiatives started in 1968, which are often referred to as 'long reform era' (Muraközy, 2008). The long-lasting effects of the market socialism still have important consequences. A whole range of countries went through a stage in which certain ingredients of market socialism were applied. Changes pointing in this direction occurred from 1949 onward in Yugoslavia and from 1953 in Hungary (Kornai, 1990). Among the socialist countries of Central and Eastern Europe (excluding Yugoslavia) the 1968 Hungarian reform can be considered as the most significant, despite all of its controversies leading to an increase of production and a rising standard of living (Muraközy, 2008). According to Kornai (1990) Hungary can rightly be considered a laboratory where some very important experiments were conducted. The economic reforms (reform socialism/market socialism) can be meant as an effort to combine socialism and capitalism to some extent.

Foreign debt accumulation started as a consequence of the first oil crisis because of the policy-makers aim to preserve well-being of the citizens. Increased indebtedness and the second oil crisis led to the introduction of new reform programs in 1982. With the aim of restoring competitiveness the most important elements of the reforms were the following: legalisation of informal activities (second economy), official recognition of small private firms (especially in the service sector), the opportunity for private firms to enter the financial market by issuing bonds, the formation of a two-tier banking system and the introduction of a new, market-conform tax system (Benczes, 2011).

[3] For detailed introduction to the transition stages of Hungary see Annex 2.

How did all these reform processes affect welfare services?

The market reforms from the early eighties led to marketisation which significantly increased both aggregate and individual-specific uncertainty; as compensation, the state did not hesitate to embark on generous welfare programmes. Welfare services became tools of the short-sighted state elites for compensating the losers of the economic reforms. As a consequence of these reform programmes, generous welfare spending became and is still an untouchable part of social rights, making the conduction of the necessary reforms even more difficult from a political point of view (Benczes, 2011).

Political change opened the door to radical economic reforms to replace the system of central planning, however economic restructuring requires more time than revolutionary political upheaval. Only a few Eastern European countries realised how challenging this process would be (Somogyi, 1993). The major problems of perfecting market economy were the unemployment and the capital shortage in these countries. At that time (before the first free election) Hungary had several favourable reforms laid down in advance, such as an almost complete price liberalisation, the Companies Act[4] and the Transformation Act[5] and an evolving spontaneous privatisation (Csaba, 1995). Since several reforms were implemented there was no need to apply a big bang approach for the transition. Hungary is often picked up as an example of gradualism, however for example the bankruptcy law of 1992 represents a classical case of big bang approach and even the big bang approach advocates of some sort of gradualism (Carmignani, 2003).

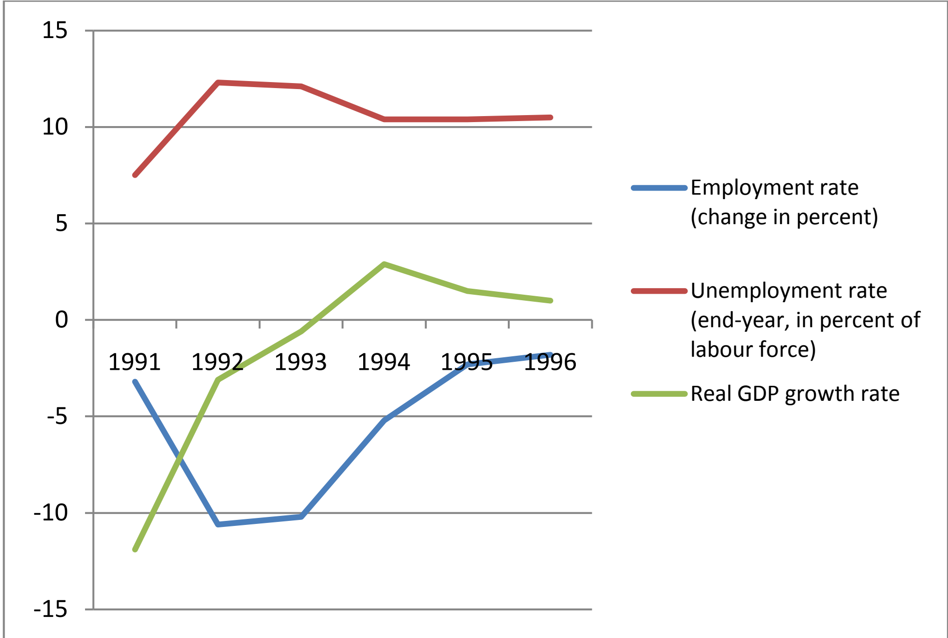
Hungary is often cited as a prime example of gradualism (Condon – Dervis, 1993) based on the lack of shock therapy compared to countries like Poland, Bulgaria or Russia. In the context of post-socialist transition gradualism was applied to avoid political conflict, it was equalled to timidity and unwillingness to change (Csaba, 2011). The overall unique feature of the Hungarian transformation can described as “transformation without stabilisation” (Csaba, 1995:195). To link Hungary’s experience to the debate on the speed of the transition Benczes (2011) claim that the gradualist character of the Hungarian transformation was not the result of a conscious decision of the freely elected government, but a historically determined path dependent outcome of a two-decade long reform process which culminated in the political change of 1989. The early years of the Hungarian transformation, however, were burdened with ambiguity and a lack of coherence in policy decisions.

[4] Enacted on 1 January 1989 in Hungary, the Companies Act (Act VI of 1988 On Economic Associations) introduced the complete structure of economic associations with and without legal entity. (Kállay – Lengyel, 2008)

[5] Taking effect on 1 July 1989, the Transformation Act (Act XIII of 1989 on the Transformation of Economic Organisations and Economic Associations) was designed to control how organizations can be transformed into one of the new forms introduced by the Companies Act. (Kállay – Lengyel, 2008)

On the one hand the socialist system was characterised by full employment consequently there was no need for unemployment insurance, on the other hand the contributions to the pay-as-you-go system was fully secured. Thus before 1989 budget deficit was financed by the significant surplus of the pension fund. Transition brought salient restructuring which led to dramatic decline in employment. Therefore in 1989 Hungary introduced a system of unemployment compensation and then established an insurance-type unemployment benefit system in 1991 (OECD, 1995). The pension system bore the brunt of costs of the introduction of a new system.

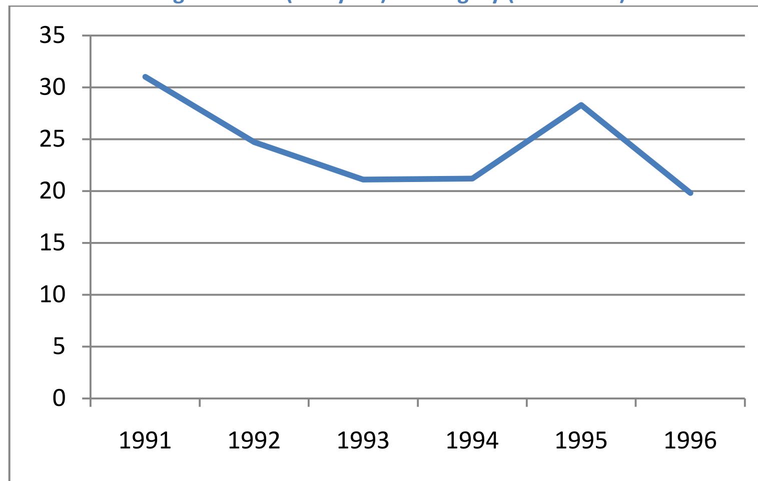
Figure 3. Development of labour force in Hungary (1991-1996)



Source: IMF (1997) pp. 5.

Due to the transformation recession the welfare system being so generous was placed under even more financial pressure aggravating further its unsustainability. In an effort to dampen the additional burdens, the government resorted to inflate expenditures in an era of double-digit inflation (Figure 2). Between 1989 and 1996, the real value of welfare expenditures decreased by 35 percent (Ferge 1999:165). As a consequence, tensions over the sustainability of pay-as-you-go systems increased in a more vigorous way.

Figure 4. CPI (end year) in Hungary (1991-1996)



Source: IMF (1997) pp. 5.

By the early 1990s, a drop of the universally provided welfare services can be observed. As part of this process, the previous health care service was replaced by a compulsory insurance-based system.

During the 1990s the labour force participation (especially for women) fell significantly, while a rise in unemployment can be observed, which was especially sharp for men. Government-supported pension policies, intended to mitigate the effects of declining labour demand, were mainly responsible for the decrease in participation. Most people leaving the labour market became eligible to some social provision, such as old age pension, disability pension, or maternity allowance. By 1995, the share of benefit recipients among the working age population reached 31 per cent. Pension schemes were used to reduce open unemployment since the mid 1980s and after the transition this practice was expanded (Duman – Scharle, 2011). This compensation process carried out by the extension of pension schemes could dampen the negative effects of the transition, however in the long run it has become the cause for the unsustainability of the pension system.

During the 1990s studies show that the cutting back of the “premature welfare state” was successfully achieved in Hungary. During the decade after transition the decrease in welfare expenditure of the government budget was significant. The decrease in expenditure did not really mean the real reform of the welfare systems and the solution of their problems. Basic problems can be determined as following: (i) still very high welfare expenditures, (ii) the lack of systematic reform of the big allocation systems, (iii) the citizen’s perception of worsening quality of public services despite the high costs. The welfare system cannot really help to solve the worsening social and income problems following the change of the political system (Muraközy 2004).

Fiscal consolidation period for Hungary started in March 1995 (nine months after the election held in 1994). This can be concluded as an institutional shock therapy (Bokros 'package'), fiscal adjustment and reforms were introduced with salient expenditure cuts, using the tool of surprise inflation and introducing the crawling devaluation of the currency (Csaba, 2009). In the course of stabilization the government intended to rein the domestic demand through income policy restrictions on the flow of wages, by freezing the salaries in budget institutions and public companies. The inflation rate increased to over 26 per cent due to the discretional measures (devaluation, additional customs duty) of the stabilization package resulted in the rocketed inflation of 29 per cent. Accordingly, the real wages were devalued by 10-12 per cent, thus the competitiveness went through an improving phase. The domestic demand orientation turned into export orientation which became decisive in the area, and the rate of welfare expenditures went through a significant shrinkage in proportion of GDP. Before the consolidation the deficit was 5-7 per cent of GDP two years in a row, and this fact forced the government in 1995 to intervene through the introduction of a tuition fee in higher education, the application of needs-based principles in the social supply system. Furthermore, the maternity benefit (GYED) and the maternity leave (GYES) were bound to income limit; the retirement age was raised to 62 years and co-payment was introduced for some health services (e.g. dentistry, pulmonary screening) (Horváth et al, 2006).

The 1995 stabilization resulted in a remarkable, but merely provisional decrease in expenditures. The increase in spending began again especially since 2000, and its speed became faster in 2002. The consolidation could not be durable. By now we can claim with reasonable certainty that the temporary cut in the affluent welfare expenditures, without any notable structural changes, are counter-incentives of the successful long-run stabilization (Tagkalakis, 2009).

As a reaction to the pressure on the pension system, there was a wide-spread feeling among decision-makers that to solve the short- and long run problems of the pension system, it should also be partially privatised and prefunded. After long-standing debates the new three-pillar pension system was introduced in 1998 (Simonovits, 2009) and maintained until January 2011 (Égert, 2012). The first pillar is a traditional pay-as-you-go system, the second pillar was a fully-funded private pension fund scheme based on mandatory contributions until the reform in 2011, now operates as a pension fund only for the 3 per cent of the insured. The third pillar introduced in 1993 is a voluntary private pension fund (Parniczky, 2000). Hungary undertook significant reforms with the introduction of a funded second pillar in 1998 (and third pillar in 1993) in order to reduce pressures of the rather expensive social security system, but these changes have recently been reversed, making the

prognosis for the future rather uncertain (OECD, 2012). Currently the pension system seems to be unsustainable.

Hungary underwent a 'cold shower' consolidation in 1999 (and another in 2003), however, every episode of fiscal tightening was followed by an even stronger fiscal expansion. Despite a so-called 'cold-shower' fiscal consolidation after the elections in 1998, the increase of expenditures was substantial, so it can be concluded that the 'cold-shower' adjustment was an unsuccessful attempt. As for the revenue side, the tax brackets were halved and the government also mitigated the amount of the social security contribution paid by the employers. The reason behind the increasing expenditures was partially the dominance of domestic demand and consumption-driven economic policy with its already introduced measures (salary increase in the public sector, public transfers such as pension increase).

To sum up we can say that only reform of the pension system was carried out in 1998, any other comprehensive reforms were put off, however the pay-as-you-go system was reinstalled again in 2011. After the Bokros package (in 1995) there was no development in this field, although this would have been the most desirable way to decrease government expenditure in the long run, and would have moderated public consumption, and would have given resources for sustainable growth.

3. Specific features of the Hungarian transition

3.1 The role of the local governments in the welfare system

As far as the social insurance system is concerned, the local governments are responsible for the provision of the services. The Hungarian public finance system can be divided into two levels and four sub-systems. The central budget plays the major role at the level of the central government, furthermore, the Health Insurance Fund and the Pension Insurance Fund and the separated state funds belong here as well. The second level is the sector of local governments (Kovács, 2006). Hungary was one of the first transition countries which implemented a reform of its intergovernmental system. After the transition as a result of a series of legislative acts and reforms in 1990 and 1991 Hungary abandoned its old three-tier system and established the legal framework for a two-tier system of government. The Law on Local Self-government[6] dramatically reduced the responsibilities of the 19 counties and the autonomy of local governments was increased. Citizens were granted the right to establish autonomous self-governments. The problem of the decentralisation process was that it was driven in large part by a political intent to diminish the old

[6] Act LXV of 1990. Available in Hungarian at http://net.jogtar.hu/jr/gen/hjegy_doc.cgi?docid=99000065.TV

system, but as a consequence it led to excessive fragmentation (Dethier, 2002). This fragmentation means that there are now approximately 3200 local governments, the average number of inhabitants per municipalities is less than 3200, and about 1670 local governments have less than 1000 inhabitants (Vigvári, 2009**).**

Welfare services have been mainly provided by the local governments which resulted in the indebtedness problem of the local tier. The wide range of compulsory provision of local public services entails that local governments are obliged to provide primary education, basic health and social welfare provisions, waste disposal, safe drinking water, public lighting, and to maintain local public roads and cemeteries. They are also obligated to enforce the observance of rights of national and ethnic minorities. Other tasks, which are not all mandatory, include providing local mass transport, settlement development, snow removal, fire protection, and public security and the explicitly voluntary provision of cultural and sports facilities, housing, and public safety (Dethier, 2002). As part of the reform processes with the new Act on Local Governments 2011 the voluntary tasks can be delegated to the local governments only if their maintenance does not endanger the mandatory tasks. Further limitation is that these voluntary tasks can be financed only by own revenues or by other financial sources especially assured for them. Another tool to handle the indebtedness problem of local governments is that education is operated by the central government since September 2012.

The local governments are important economic actors, on the one hand the supply of public services influences the labour market and on the other hand they are significant debtors. Between 2001 and 2007 government debt increased continuously, reaching 66 per cent of GDP, the general government deficit was the highest in this period, and it was accompanied by much slower GDP growth (*Table 1.*). At third quarter of 2011 government debt reached 82.6 per cent of GDP (Eurostat 2012). Special feature of this period is the debt-generating role of local governments. In 2001 the contribution to public debt of the local governments was 0.4 per cent of GDP, in 2005 it was 1.7%, and this share intensified further reaching 2.9% in 2007. It can be concluded that between 2001 and 2007 15 per cent of debt growth can be attributed to the local governments (*GKI* 2011). The dynamic has continued, the total debt of the local governments between 2006 and 2009 doubled, increasing to 3.9% of the GDP (Széll Kálmán Plan 2011).

Table 1. The main features of indebtedness in Hungary (1990-2010)

	Average budget deficit (% of GDP)	Average annual change of the debt to GDP rate (percentage point)	Real GDP index (%, 100 = previous period)	Debt ratio (% of GDP)	
1990-1994	5.3	3.4	85	1994	90
1995-2001	5.6	-5.3	126	2001	52
2002-2007	7.5	2.3	122	2007	66
2008-2010	4.1	4.7	95	2010	80

Source: *GKI* (2011) pp. 2.

Obviously, the introduction of a debt break for the local governments is essential in order to dampen their bias towards indebtedness. The main problem of the welfare system is the fulfilment of public services in a better quality and different structure, e.g. the share of education is considerably lower in Hungary than the OECD average. Equal access to public services has to be ensured, however the fragmented local governmental structure does not make it possible. The current nationalisation of public services tends to solve this shortcoming of the Hungarian system, but because of the short time frame it is far beyond the scope of our analysis. Without change in the financing system the current local governmental and welfare system as well are unsustainable.

3.2 Gender aspects of the transition process

Why are gender dimensions of salient interest in contemporary post-communist welfare regimes? Communist welfare states were distinctive in their treatment if women, the system can be characterized as "dual breadwinner, double burden" system (Cook, 2010). However there were several special benefits for women including extended maternity leaves, subsidized child care and generous family benefits (especially in Hungary and Poland), at the same time the division of domestic work was extremely unequal, the share of women's unpaid care work was dominant (Pascall – Lewis, 2004).

As a consequence of the transition high unemployment and economic insecurity have affected women more, undermining the previous dual breadwinner model. Women's labour market employment rates have fallen dramatically. Labour market participation is a key measure of gender inequality. Employment among women dropped dramatically in all CEE countries; however gender-specific discrepancy in employment rates is lower in all CEE countries (except the Czech Republic) than in the Western EU countries. In CEE countries the end of state socialism has brought diminishing support for women's labour market participation (Pascall – Kwak, 2010: 117).

The following table concludes the major developments of employment with special focus on the differences between genders. Beside the CEE data the Swedish data represent the dual earner model, the French the modified male breadwinner, while the Irish the strong male breadwinner

model, Germany is represented as a benchmark. Gender differences can be measured by different indicators as well, such as job security, gender pay gap, part-time work, parental leave, but the picture for the region and Hungary is quite similar in this regard. In terms of unemployment rate it can be concluded that the changing economic circumstances make both men and women vulnerable to losing jobs.

Table 2. Gender differences in employment rates in CEE and reference countries

	2000			2007			2011		
	Males	Females	M-F difference	Males	Females	M-F difference	Males	Females	M-F difference
EU (27 countries)	76.0	57.3	18.7	77.8	62.1	15.7	75.0	62.3	12.7
Bulgaria	60.2	50.7	9.5	73.4	63.5	9.9	66.6	61.2	5.4
Czech Republic	80.2	61.9	18.3	81.5	62.4	19.1	79.9	61.7	18.2
Estonia	72.4	62.9	9.5	81.4	72.5	8.9	73.5	67.6	5.9
Latvia	68.2	59.3	8.9	80.1	70.7	9.4	67.5	65.3	2.2
Lithuania	67.4	63.9	3.5	76.5	69.5	7.0	67.5	66.6	0.9
Hungary	68.9	53.9	15.0	70.2	55.5	14.7	66.8	54.9	11.9
Poland	68	54.2	13.8	70.2	55.5	14.7	72.2	57.6	14.6
Romania	75.4	63.0	12.4	71.0	57.9	13.1	69.9	55.7	14.2
Slovenia	73.2	63.6	9.6	77.5	67.1	10.4	71.8	64.8	7.0
Slovakia	70.0	57.2	12.8	76.0	58.7	17.3	72.7	57.6	15.1
Germany	76.5	60.9	15.6	79.1	66.7	12.4	81.4	71.1	10.3
Ireland	82.8	57.9	24.9	83.0	64.4	18.6	68.2	59.4	8.8
France	75.6	60.3	15.3	75.0	64.8	10.2	73.9	64.7	9.2
Sweden	80.1	75.3	4.8	83.1	77.1	6.0	82.8	77.2	5.6

Source: Eurostat

In case of Hungary, employment rate is one of the lowest, and women's labour market participation has decreased and reformed social security systems have further negative impacts on gender discrepancies. However these results are even better than for the Mediterranean countries, where traditionally women's labour market participation is much worse. When we would like to understand the real nature of the situation in Hungary we have to bear in mind that market participation was compulsory for both gender, CEECs and Hungary were an example of the dual earner model, in which women were supported as full-time workers, with high levels of support of childcare, family benefits and parental leave, high public expenditures on health care and education services, and generous welfare entitlements.

4. Concluding remarks

Hungary is one of the worst-hit countries of the current financial crisis among the CEE countries. The deteriorating economic performance of the country has its historical roots. A high ratio of redistribution, a high and persistent deficit and accelerated indebtedness are the consequences of the communist and the post-communist period.

It can be concluded that gradualism in the Hungarian transition was applied to avoid political conflict, it was equalled to timidity and unwillingness to change with a few elements of big bang approach as well. The gradualist character of the Hungarian transformation was not the result of a conscious decision of the freely elected government, but a historically determined path dependent outcome of a two-decade long reform process which culminated in the political change of 1989. The early years of the Hungarian transformation, however, were burdened with ambiguity and a lack of coherence in policy decisions. For further policies the culture and routine of gradualism lead to the resistance to shock-therapy.

The welfare expenditures are still very high, they are over OECD average, however the gap has started to close by 2010. The citizens perceive worsening quality of public services despite the high costs. Creating welfare state generosity ratio, it can be concluded that Hungary ranks in the middle, however in general generosity has been significantly decreased, but further reforms are needed.

There is a lack of systematic comprehensive reform of the big allocation systems which has been accompanied with hectic changes of the taxation system. As far as the social insurance system is concerned, the local governments are responsible for the provision of the services which resulted in the indebtedness problem of the local tier. In 2011 reform of the local governmental system took place to handle this process. By now we have enough empirical evidence to claim with reasonable certainty that the temporary cut in the affluent welfare expenditures, without any notable structural changes, are counter-incentives of the successful long-run stabilization.

To dampen the negative labour market consequences of transition, government-supported pension policies were intended to mitigate the effects of declining labour demand. Most people leaving the labour market became eligible to some social provision, such as old age pension, disability pension, or maternity allowance. By 1995, the share of benefit recipients among the working age population reached 31 per cent. Pension schemes were used to reduce open unemployment since the mid 1980s and after the transition this practice was expanded. This compensation process carried out by the extension of pension schemes could dampen the negative effects of the transition, however in the long run it has become the cause for the unsustainability of the pension system. By socio-economic

transition the long-run evaluation of any compensation scheme is a key issue for managing sustainability in the long run.

Transition have had different impact on women, one of the most crucial element of these changes are the gender specific differences of labour market participation. As a consequence of the transition high unemployment and economic insecurity have affected women more, undermining the previous dual breadwinner model. Women's labour market employment rates have fallen dramatically. Labour market participation is a key measure of gender inequality, employment among women dropped dramatically in all CEE countries; however gender-specific discrepancy in employment rates is lower in all CEE countries (except the Czech Republic) than in the Western EU countries. Hungary's situation (beside Poland) is special because female employment is the lowest. In general we can conclude that in the CEE countries the end of state socialism has brought diminishing support for women's labour market participation.

Building up a modern and efficient market-driven welfare state in post communist economies requires decades for reaching political consensus in different approaches (health, housing, education, research, etc.) and developing institutional and legal framework. Even the most advanced CEE economies are at the very beginning of this process, and low quality of political debates and political elites can be described as the major obstacles on this way (Koźmiński, 2011). In general at any socio-economic transition the correct configuration of the time frame is a key factor in order to avoid unrealistic expectations and growing resistance in the long run.

Annex 1.

Table 1. Welfare state generosity ratio for OECD countries (1980-2011)

Year/Country	1980	1985	1990	1995	2000	2005	2009	2010	2011
Nordic countries									
Denmark	1.09	1.01	1.05	1.30	1.37	1.39	1.37	1.26	1.23
Finland	..	1.27	1.46	1.04	0.98	1.08	1.17	1.15	1.12
Netherlands	1.03	1.13	1.25	1.17	1.22	1.10	1.26	1.19	1.18
Norway	1.47	0.97	1.03	1.12	1.15	1.12	1.32	1.26	1.24
Sweden	..	1.45	1.54	1.20	1.23	1.17	1.14	1.06	1.05
Group mean	1.19	1.17	1.27	1.17	1.19	1.17	1.25	1.18	1.16
Coeffiecient variation	16.14%	15.10%	16.41%	7.38%	10.49%	9.75%	6.89%	6.29%	6.06%
Anglo-Saxon/Liberal									
Australia	0.66	0.65	0.73	0.79	0.92	0.92	0.94	0.96	..
Canada	0.81	0.82	0.93	0.88	0.85	0.85	0.87	0.84	..
New Zealand	..	..	1.14	1.03	1.06	1.14	1.12	1.09	..
Ireland	..	0.73	0.68	0.77	0.86	1.04	1.02	0.94	0.88
Switzerland	..	..	0.81	0.97	0.99	1.00	..	0.96	..
United Kingdom	..	0.73	0.74	0.81	0.87	1.00	1.00	0.97	0.96
United States	0.72	0.69	0.75	0.85	0.89	0.92	0.87	0.88	0.89
Group mean	0.73	0.73	0.83	0.87	0.92	0.98	0.97	0.95	0.91
Coeffiecient variation	8.75%	7.40%	17.91%	10.31%	7.67%	9.09%	9.33%	7.61%	3.98%
Continental									
Austria	..	1.33	1.31	1.41	1.40	1.27	1.32	1.31	1.26
Belgium	..	1.04	1.12	1.04	1.07	1.03	1.18	1.15	1.19
France	1.02	1.12	1.07	1.09	1.09	1.19	1.25	1.23	1.20
Germany	..	..	..	1.13	1.11	0.91	1.00	0.99	0.99
Group mean	1.02	1.16	1.17	1.17	1.17	1.10	1.18	1.17	1.16
Coeffiecient variation	..	13.13%	10.87%	14.14%	13.43%	14.66%	11.58%	11.88%	10.32%
Mediterranean									
Greece	..	0.76	0.80	0.72	0.69	0.75	0.85	0.75	0.65
Italy	0.86	0.92	0.80	0.70	0.79	0.91	0.99	0.97	0.95
Portugal	0.55	0.49	0.68	0.75	0.94	0.93	0.94	0.89	0.81
Spain	0.70	0.54	0.67	0.56	0.66	0.81	0.75	0.71	0.67
Group mean	0.70	0.68	0.74	0.68	0.77	0.85	0.88	0.83	0.77
Coeffiecient variation	22.65%	29.83%	9.92%	12.01%	16.60%	10.15%	12.26%	14.25%	18.42%
CEEC									
CEEC CME									
Czech Republic	..	..	..	1.02	0.85	0.85	0.97	0.94	0.95
Hungary	..	..	..	..	0.96	0.98	0.91	0.82	0.79
Poland	..	..	..	0.92	0.72	0.68	0.99	0.94	0.88
Slovenia	..	..	..	..	1.03	0.96	1.02	0.99	0.96
Group mean	..	..	..	0.97	0.89	0.87	0.97	0.92	0.90
Coeffiecient variation	..	..	..	6.85%	15.08%	15.89%	4.94%	8.18%	8.92%

CEEC LME									
Estonia	..	..	..	..	0.49	0.53	0.65	0.59	0.63
Slovak Republic	..	..	..	0.79	0.60	0.59	0.78	0.72	0.70
Group mean	..	..	..	0.79	0.55	0.56	0.71	0.65	0.66
Coeffiecient variation	..	..	..	..	13.88%	7.09%	13.07%	13.86%	6.93%
Other OECD countries									
Iceland	..	..	..	0.94	1.10	1.14	0.97	0.92	0.92
Israel	..	..	..	1.05	0.91	0.86	0.90	0.94	
Japan	0.92	0.87	0.79	0.80	0.74	0.76	0.83	..	..
Korea	..	..	0.38	0.41	0.41	0.50	0.67	0.62	..
Luxembourg	..	1.24	1.28	1.25	1.29	1.21	1.24	1.26	1.20
Mexico	..	..	..	0.37	0.67	0.74	0.72	0.70	..
Chile	..	..	0.84	0.98	0.78	0.63	0.60	0.56	..
Turkey	..	0.21	0.48	0.47	..	0.61	0.64	..	..
Overall mean	0.89	0.90	0.93	0.91	0.93	0.93	0.98	0.95	0.97
Coefficient variation	28.72%	34.70%	31.92%	27.73%	25.61%	23.61%	21.62%	21.52%	20.60%

Notes and sources: Country groups are created based on Sapir (2006) and the cluster analysis conducted by Schweickert (2013). Methodology based on Castles (2004) pp. 37, Table 2.4. Using different data sources there are slightly different results for some countries in year 1980. Welfare state generosity ratio is calculated by dividing social expenditure data (total public social expenditure as a percentage of GDP – OECD SOCX dataset) by the sum of the percentage of the population aged 65 and over (percentage of total population – World Bank data) and the percentage of the civilian population unemployed (total unemployment rate as percentage of total labour force – World Bank data). All calculated figures are subject to rounding errors.

Annex 2.

Stages of the transition process

1. Institution-building directing inherently towards a gradual transition into market economy (1980s-1990)

During the socialist period, Hungary was the most open among the CEE countries because of historical ties with Western Europe and the specific socio-political compromise of the Kadar era. In 1982 small private firms were recognised, informal activities were legalised (Benczes, 2011), this year Hungary joined the IMF and the World Bank in the wake of a severe liquidity crisis. Hungary sought IMF membership to safeguard its reforms and get assistance with its foreign debt (Cohn, 2009). Other important element of economic reform processes were the introduction of soft-bankruptcy law (1984, 1986), the establishment of the two-tier banking system (1987) and the tax reform in 1988 (progressive personal income tax, gross and net income, corporate tax, VAT) (Blejer – Sagari, 1991). In 1990 a multi-party election took place for the first time since World War II, the government was formed by Hungarian Democratic Forum party, lead by József Antall, along with the Alliance of Young Democrats, a party with a libertarian free market-orientation, and several other smaller parties (Buss, 2000).

2. The stage of gradual-transition (1990-1995)

Hungary employed a gradualist approach in its transition strategy and as a consequence of its earlier introduced economic reforms, and it was accompanied with the formation of a 'pre-mature' welfare state. Under Antall legal institutions (economic and political) were set up in record time, political regime change (private ownership, market-friendly political power, trade and price liberalisation, freeing up labour market, diminishing the barriers against private enterprises) took place. The government accomplished much, but was unable to politically enforce economic discipline necessary to privatize the economy, reduce growing budget deficits, and pay off increasing public debt (Buss, 2000). This was the time when privatization was accelerated, choosing its own unique path[7]. The prolonged economic recession led to the re-election of the Communist Party, renamed the Hungarian Socialist Party, in May 1994. Transformation recession totalled at 18 per cent of the GDP by 1993, Hungarian GDP only reached its 1989 level in 2000. At the same time total employment fell by 24 per cent between 1989 and 1997, most dramatic in the region. Real wages in 1999 were on average 15 per cent less than in 1989 (Fink, 2006). The fall in employment generated new challenges and the introduction of special welfare services.

[7] For detailed analysis see: Papp et al. (1998), Mihályi (1997a) and Mihályi (1997b).

3. The stage of the stabilisation package and its legacy (1995-2000)

Nine months after its victory the government decided to start a fiscal consolidation in March 1995 which consisted of restrictive fiscal policy and an expansive monetary policy. The depreciation of the currency by 9 per cent (followed by the adoption of a pre-announced crawling peg system with a band of +/- 2.25 per cent) resulted in surprise inflation. In the following years the new system restored the predictability of monetary policy. Surprise inflation could contribute to the decrease of public expenditure in real terms (Horváth et al., 2006). The introduced austerity measures concerned the higher education system (introduction of a tuition fee), the family benefits, the pension and health care system. There was temporary cut in the affluent welfare expenditures, without any notable structural changes. The negotiations about EU accession started in 1997, Hungary was selected as first of these countries within this region (Magnin, 2002). In May 1998, new elections were held, the socialists were replaced by the Alliance of Young Democrats, led by Viktor Orban, and a coalition parties, including the Hungarian Democratic Forum. The increase of social spending started this time again, while jeopardizing gains made in budget deficit and foreign debt reduction (Buss, 2000). Hungary underwent a 'cold shower' consolidation in 1999 (and another in 2003), however, every episode of fiscal tightening was followed by an even stronger fiscal expansion. A comprehensive reform of this period was the introduction of the new three-pillar pension system in 1998 (Simonovits, 2009), it was maintained until January 2011 (Égert, 2012). 2000 was chosen as a turning point because increase in spending intensified again especially since this year.

4. The stage of temporary improvement and lasting decline (2000-2006)

The beginning of this period was characterised by increasing inflation reflecting the problems of the narrow exchange rate band. Inflation, which declined significantly in the period of 1995–99, began to creep up again. In May 2001, the authorities decided to widen the fluctuation band around the forint parity against the euro to 15 percent, which was too wide to serve as a useful nominal anchor (Jonas – Mishkin, 2004). The inflation targeting (IT) regime was introduced in Hungary in 2001. Successful and fast disinflation strategy was hindered by large shocks, so it took four years to bring inflation in the vicinity of price stability (Csermely et al. 2007). Hungary's EU accession took place in 2004, and about the effect of the intensive competition for EU membership one can conclude that it triggered some of the controversial but necessary decisions over structural reforms (Csaba, 2004). Special feature of the Hungarian economy is that difficulties arose five years earlier that global economic crisis hit other states seriously. Main economic problem is the increasing level of overspending, however as a consequence of relatively good economic performance (average growth rate between 2001 and 2006 was 4.2 per cent) it became obvious later on (Egedy 2012). This period can be

characterized by pro-cyclical and lax fiscal policy with increasing deficit and debt-to-GDP ratio. Hungary has been under excessive deficit procedure since its accession.

5. The stage of stabilisation and the unexpected spill-over of the crisis 2008 (2006-2010)

In spring 2006 socialists were re-elected, and it turned out soon that economic outlook, especially, the fiscal deficit was much worse than it was communicated before. After years of lax fiscal policy the old-new socialist-liberal coalition started consolidation. The consolidation package included, among other measures, cuts in the staff of the ministries, but was mainly revenue-driven (a 4% solidarity tax levied on companies' pre-tax profit, de facto raising the corporate income tax rate to 20% from 16%, solidarity tax for Individuals earning more than EUR 2000 a month, 15% VAT rate was raised to 20%), expenditure-side measures were radical cuts of subsidies on gas and electricity prices. The government reduced general government deficit, and initial steps of reforms in the health care system have been introduced, but then abolished on a referendum. To reshape the education and local governmental system remained plans, and the ruling coalition broke (Richter, 2012). The crisis found Hungary in a vulnerable state because of the shock of the consolidation; recovery was interrupted by the financial crisis. In 2009 GDP shrunk to nearly 7 per cent, which was well below the average recession rate within EU27 (-4.2 per cent). In October 2008, Hungary requested a Stand-By Arrangement from the IMF in the context of a rapidly spreading global financial crisis (IMF, 2012). The European Commission and the World Bank also provided funds to cover the financing gap. The stabilisation package amounted to 20 billion euros, EUR 12.5 billion stand-by agreement with the IMF, EUR 6.5 billion from the European Union and EUR 1 billion from the World Bank. After a confidence vote, in spring 2009 the next wave of fiscal consolidation was launched by a new, technical government headed by Gordon Bajnai. The introduced measures cut expenditures (13th month pension, sickness allowance) and on the revenue side VAT was increased from 20 per cent to 25 per cent (Richter 2012). As a result, Hungary's external financial position improved and in 2009 the government returned back to market-based financing of the public debt. 2010 was time for a political turning point, the centre-right party alliance of FIDESZ-KDNP (Fidesz Hungarian Civic Alliance – Christian Democratic People's Party) had a landslide victory on the elections, by gaining more than two third of the mandates (Vida, 2012).

6. The stage of crisis management 2010-2013

The new government's main aim is to balance public finances (reducing indebtedness, keeping budget deficit close to 3 per cent) and to increase employment. The government introduced several

measures such as downsizing public administration, the reform of the pension system, and new special taxes on telecommunication, financial, retail and energy sectors (Vida 2012).

Annex 3.

Summarising the development of the social security system in Hungary

Table 2. The development of social security in Hungary

Period of time	Benefitting group	Types of insurances	Financing	Management and control
1952-1989	wide, unified entitlements	health-, accident-, pension insurance in the group of compulsory insurance system	contributions and budgetary support without autonomous financial and asset management	state controlled union management and supervision
after 1989	the principle of compulsory social insurance system; the range of contributors decreased due to the rising unemployment	beyond the health-, accident-, and pension insurance, unemployment benefit system was added; after 1998, the second pillar in the pension system was introduced (mandatory private pension system)	contributions, voluntary contributions, state guarantee and market-based asset management in a narrow extent	local governments created on corporative principle; after 1998, nationalisation, separate fund for unemployment benefit system
after 2010		*de facto* nationalisation of the second pillar (mandatory private pension assets) to reduce budgetary deficit and debt-to-GDP rate (9% of the GDP); reviewing early retirement schemes as well as disability pensions	employer and employee contributions; new taxes (special tax on financial organisations, telecommunication, retail and energy services); public work programme for unemployed	reduction of the role of the local governments (since 2012 education system is operated exclusively by the state)

Source: Vigvári (2009) and own collection

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Project Information

Welfare, Wealth and Work for Europe

A European research consortium is working on the analytical foundations for a socio-ecological transition

Abstract

Europe needs a change: The financial crisis has exposed long neglected deficiencies in the present growth path, most visibly in unemployment and public debt. At the same time Europe has to cope with new challenges ranging from globalisation and demographic shifts to new technologies and ecological challenges. Under the title of Welfare, Wealth and Work for Europe – WWWforEurope – a European research consortium is laying the analytical foundations for a new development strategy that enables a socio-ecological transition to high levels of employment, social inclusion, gender equity and environmental sustainability. The four year research project within the 7th Framework Programme funded by the European Commission started in April 2012. The consortium brings together researchers from 33 scientific institutions in 12 European countries and is coordinated by the Austrian Institute of Economic Research (WIFO). Project coordinator is Karl Aiginger, director of WIFO.

For details on WWWforEurope see: www.foreurope.eu

Contact for information

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Partners

Partner	Short name	Country
Austrian Institute of Economic Research	WIFO	Austria
Budapest Institute	Budapest Institute	Hungary
Nice Sophia Antipolis University	UNS	France
Ecologic Institute	Ecologic	Germany
University of Applied Sciences Jena	EAH Jena	Germany
Free University of Bozen/Bolzano	FUB	Italy
Institute for Financial and Regional Analyses	GEFRA	Germany
Goethe University Frankfurt	GUF	Germany
ICLEI - Local Governments for Sustainability	ICLEI	Germany
Institute of Economic Research Slovak Academy of Sciences	IER SAVBA	Slovakia
Kiel Institute for the World Economy	IfW	Germany
Institute for World Economics, RCERS, HAS	KRTK MTA	Hungary
KU Leuven	KUL	Belgium
Mendel University in Brno	MUAF	Czech Republic
Austrian Institute for Regional Studies and Spatial Planning	OIR	Austria
Policy Network	policy network	United Kingdom
Ratio	Ratio	Sweden
University of Surrey	SURREY	United Kingdom
Vienna University of Technology	TU WIEN	Austria
Universitat Autònoma de Barcelona	UAB	Spain
Humboldt-Universität zu Berlin	UBER	Germany
University of Economics in Bratislava	UEB	Slovakia
Hasselt University	UHASSELT	Belgium
Alpen-Adria-Universität Klagenfurt	UNI-KLU	Austria
University of Dundee	UNIVDUN	United Kingdom
Università Politecnica delle Marche	UNIVPM	Italy
University of Birmingham	UOB	United Kingdom
University of Pannonia	UP	Hungary
Utrecht University	UU	Netherlands
Vienna University of Economics and Business	WU	Austria
Centre for European Economic Research	ZEW	Germany
Coventry University	COVUNI	United Kingdom
Ivory Tower	IVO	Sweden