

Non-Technical Summary

CERGE-EI / GDN Project “Redistribution of Resources among generations”

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We applied the technique of generational accounting so as to quantify sustainability of and intergenerational redistribution in Hungarian public finances. We submitted a paper to *Keizai Kenkyu (Economic Review, Japan)* on a part of this study measuring sustainability and intergenerational redistribution in the largest chapter of social spending, the public pension system.¹ Since the Hungarian pension system went through a large scale reform in 1998, we could also scale the effects of the institutional changes on sustainability and intergenerational redistribution. The effects of particular elements of the reform package were calculated separately.

Our calculations of the no-reform scenario suggest that the Hungarian public pension system was unsustainable in the long-term without the comprehensive reform package. The per capita account of future generations is \$13,600, while that of the zero year old is a mere \$1,200. This difference provides the most important index, the so-called generational imbalance, of generational accounting. If deficits in the system are devolved entirely on to the as-yet unborn, they will be burdened with making \$12,400 more lifetime contributions than those who are already in the system but have their whole careers ahead of them. The unreformed system was inefficient even for the newborn. This rises further with age, as older children receive orphan benefits for an ever-shorter period. The greatest net contributors are the 24-year-olds. For them it would require the immediate payment of a lump sum of more than \$6,240 to equalize lifetime contributions and benefits. For the 39-year-old, the account turns negative, i.e. they may start to expect more benefits from the system than contributions they have yet to make. Generational pension accounts favor the 59-year-old age bracket the most. They have reached the point of paying almost nothing into the system, whilst they stand to withdraw \$18,190 over their remaining period in the pension system.

The pension reform considerably reduced the severe imbalance originally prevailing in the system. The deficit of future generations fell from \$13,600 to \$650. Most of the related costs are borne by the current active generations, although, to a lesser extent, primarily due to Swiss indexation, current pensioners also bear some of the costs.

¹ The paper has been accepted by the journal for publication.

The measure of generational imbalance is based on a forward-looking calculation. If the process is completed with retrospective figures, i.e. former contributions and benefits are also taken into account, redistribution among generations can be measured directly comparing entire careers. If there are 'looser' and 'winner' cohorts, they can be sorted out.

The results coincide with international experience and show significant redistribution favorable to the first generations that enter the system. Those born after 1880, the first to enter the pension system, approximately 50 year-groups, came out winners in the pension system. The deeper the curve sinks into negative regions the bigger the lifetime-pensions compared to lifetime-contributions, that is the larger the net profits. This profit increases for the first 20-25 years continuously. Later it decreases yet remains profitable up to the now 70 year olds. From there on however, the system is a lose for every year-group. The largest net lifetime-contributors are those born between 1940 and 1955. The loss will continually decrease for those younger than them.

The effects of the pension reform on redistribution were also calculated. It showed that the reform favored future generations at the expense of currently living cohorts. The deficit for the as-yet unborn diminished to less than 5 percent of its original value. In contrast, the thirteen cohorts out of the fifteen cohorts born between 1948 and 1962 have to pay \$3,000-3,800 in addition to their lifetime net contributions they would have paid without reform. The highest supplementary charge, \$3,800, to be paid by the 1949 cohort, slowly decreases to 2,000 for the newborn. However, since the original deficit of the after-war generations was proportionately even higher, the percentage change is more serious for the currently young. Their net lifetime accounts grew larger than twice of what it would have been without reform.

In general, the 1998 pension reform made currently living cohorts pay for the costs of intergenerational redistribution that favored the first coming generations. Instead of leaving a burdensome inheritance to their successors, those already in the system decided to pay for the bill themselves.