



The Role of Housing Assets in Shaping the New Welfare Regime in Transition Countries: The Case of Hungary

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Abstract: *This paper looks at housing strategy in a wider social and economic context and argues that a household's (class) position in society depends on important life decisions, one of the most important of which is a person's employment strategy and preparation for the period of retirement (pensions), which is related to housing decisions. The main context of these decisions is the welfare regime, but also a country's economic structure (varieties of capitalism) and housing system (tax and subsidy elements of programmes). However, as the paper argues, these systems are also changing in relation to the macro effect of individual decisions.*

Keywords: home-ownership; welfare policy; east-european housing.



Introduction

This paper looks at the formation of the Hungarian welfare state after the transition from a special angle: the interaction between public policy measures and household strategies. The paper will argue that the current welfare structure has been created by the interaction between public policy aimed at mitigating the hardship of the transformation and subsequent economic challenges on the one hand and the behaviour of households on the other with respect to finding their position in the economic structure (employment strategy) and preparing for old age. In order to understand the working mechanism of the welfare system, we will focus on employment, housing and pension strategies.

Employment strategy

The political transition had an enormous effect on macro-economic trends. As a result of the transitional recession, GDP fell by 15% in the first part of the 1990s. Structural reforms (privatisation and bank reform) were accompanied by a strong fiscal stabilisation package (1995-98) and the maintenance of sound macro-economic policies. In the 1990s, changes in the labour market resulting from the closure of many previously state-owned companies and to the restructuring of the production sector led to a dramatic decrease in the employment rate. Almost 1 million employees left the job market, many of whom were pushed into early retirement or became 'entrepreneurs' (forced entrepreneurship), and the number of students increased by 50% as well. Hungary has one of the lowest activity rates in Europe as both the early retirement system and the generous maternity leave system operate as 'informal' unemployment benefits. The 2000s first saw a relative expansion of the welfare system and stable employment – partly owing to the black market, fuelled through a construction sector boom – which all came to an end with the crisis of 2008.

Individuals/households reacted very differently to the changing circumstances, where we can identify four employment strategies within Hungarian society.

Marginalised employees

Marginalised employees were unable to adapt to the changed macro-economic environment, as their education or labour experiences made it impossible for them to take jobs in the restructured economy. Right after the regime change many tried to take early retirement or escape into maternity leave (if it was possible). Many entered the informal economy, living from day to day. Generally individuals/households belonging to this group have become recipients of welfare benefits (pension, maternity benefits, unemployment and income benefits, etc.). However, none of these benefits was able to guarantee an acceptable living standard, pushing these people towards the informal economy, where an estimated 16-17% were employed in the years 2000-2005.

Any change – the introduction of austerity measures – can affect the marginalised population of welfare recipients profoundly. As their income is barely enough to subsist on, decreasing this income can have catastrophic consequences. The employment policy, from time to time, has tried to involve the unemployed in the legal job market, but it is very difficult to provide proper jobs for under-educated persons when they have to compete with the illegal sector, where the tax burden is much lower. A public work programme ('Way to Work') was



introduced in order to get unemployed into jobs. Introduced in April 2009, it forces working-age unemployed people to accept public work at a minimum wage for a few months. In 2010 a foster work programme was created, which has grown both in extent and importance over time, becoming the primary means of easing unemployment and maintaining social peace in the economically hardest hit areas.

Wage-earners

Wage-earners represent a second employment strategy. They can access a more or less stable job either in the public or in the private sector. Public-sector employees have the highest chance of keeping their jobs (teachers, jobs in the health sector, etc.), they pay their taxes and social security contributions – and thus can count on both sickness benefits and a pension – but their salaries, despite some recent raises, have lagged behind those in the private sector quite substantially. The position of wage-earners in the private sector is not so stable, and many, typically working for small companies, tend to accept/are forced to accept the tax evasion strategy of the employers. This means they receive an official – and taxed – income equal to a minimum (or close to minimum) wage plus a negotiated informal income (‘an envelope’ – cash in hands). Wage-earners – especially in the lower paid but secure state sector – often try to find a second job, in order to supplement their income. They try to arrange these second jobs – e.g. babysitting, teaching, cleaning, editing a book, etc. – in such a way that this can be exempt from tax payments.

Wage-earners rely heavily on those welfare provisions – such as sick leave, paid maternity leave, free health care or an acceptable level of pension – that are available as a result of tax and social security payments. Their second jobs – if they have one – mostly do not suffice to create adequate savings, and they must supplement their regular income. Consequently, any change in welfare policies affects them deeply.

Entrepreneurs/self-employed

Entrepreneurs/self-employed represent the third strategy, which can be a choice based on the evaluation of the risks and rewards of the options, but it can also be forced, as wage-earners sometimes have no other option to survive but to set up their own enterprise. Larger companies and organisations often prefer to subcontract ‘one-person entrepreneurs’ rather than employ them because of the lower costs associated with this. Thus, larger or smaller companies often provide regular work for the self-employed, thereby concealing what is actually employment, and saving money both for the employee and employer.

Self-employed/entrepreneurs by choice often start their business gradually, typically taking second jobs first and then turning the second job into a business. A few, when presented with a rare opportunity, ventured straight into their enterprises, others felt that it was not possible to secure the high living standard they wanted to achieve otherwise. All entrepreneurs enjoy a relatively large degree of freedom with regard to taxes, and the self-employed usually pay taxes and social security on a minimum or ‘reduced’ wage; the estimated tax evasion is 19 % of the total tax revenue.

The shortfall on tax and social security payments has dire consequences for the functioning of the welfare state. Income benefit programmes are underfinanced, partly as a result of the lack of state revenues. However, an important question to consider is what enforced tax collection



would bring. Many assume that a significant share of small enterprises would go bankrupt, the effect of which would be to increase the demand for income benefit programmes.

Migrants

EU accession opened up new possibilities for unrestricted migration for the Hungarian population, expanding the horizon of migration from such traditional target countries as Germany and Austria to Great Britain or Sweden. Starting later than in Poland or in Estonia, Hungarian citizens began to leave their country in response to the effects of the crisis of 2008/2009. Although the numbers have been disputed, the highest estimates put the number of Hungarians living and working in another EU country at around half a million, the lowest at around 200,000. The latest surveys suggest that Hungarians are especially eager to leave their country. And most strikingly, not just for short- and long-term employment; rather, in a survey in April 2015, 10% of the population declared that they were planning to emigrate from the country.

Housing strategy

Access to housing for newly formed households (housing as a consumer good)

Housing has always been at the centre of household financial strategies. Housing regimes (the tax regulations, housing subsidies, and social housing policy of a given period) define the framework of options newly formed households have. In the mature form of the Eastern European Housing System as it had developed to 1971 (Hegedüs and Tosics 1996), market mechanisms had a subordinate role. After the transition, the housing system underwent a dramatic transformation. Privatisation was one of the most important changes (17% of the housing stock was transferred from state ownership to sitting tenants).

However, changes in the housing finance system were even more dramatic. The state withdrew from the housing sector and abandoned its direct role. State budget subsidies were cut and the state supply of housing ceased until 2000.

After 2000, as part of a new housing regime, the government started to subsidise mortgage loans, which improved affordability despite rising house price. The subsidies (PIT allowance, duty fee exemption and a cash grant) make homeownership a favourable option against renting. Meanwhile, programmes aimed at increasing the social rental sector have failed because of their high cost and the lack of political will.

Also in the 2000s FX loans – mostly in Swiss Francs – became increasingly popular, especially as the subsidy system for HUF loans was transformed, making HUF loans more expensive than those in FX currencies. Many families opted to take up FX mortgages, often beyond their actual capacity – banks, interested in providing a loan, were very lenient. Consequently, not only did the crisis of 2008/2009 hit the Hungarian economy and housing market hard, it created a serious FX loan crisis (Hegedüs 2013).



Housing as a capital good (a form of savings)

Housing has always been considered a form of savings, and not only by homeowners, but also by tenants of public rental units. The swapping of tenancy rights among citizens in the socialist period was allowed, though payment to compensate for differences in size, quality and location were the subject of private negotiation. A quite popular way for young families to obtain a tenancy right was to have a 'life care' contract with the tenancy-right holder. After the death of the old tenant, the holder of this contract became a tenant of the public housing unit with full rights.

While the crisis has affected the idea of housing being the safest investment, it did not dispel the notions of security and reliability associated with it. Even today it is considered to be a relatively safe investment that can generate income. Homeowners are aware of the value of their homes and think of their housing wealth as something that can be used in cases of hardship. How accurately households evaluate their possibilities and options is another question. Investing into real estate – even if it is about buying a home to live in – is not always the most efficient form of savings because of the transaction costs.

Entrepreneurs often use housing as a resource and investment. In times of financial difficulties, recourse to housing is also a way for them to overcome hardships, and the same we could see in the cases of some few elderly people. In 2006 and 2007, the equity withdrawal mortgage loan became quite common in the Hungarian market, which meant that households – above the age of 65 – started to use a part of their housing wealth for consumption.

Pension strategy

The transition of the welfare state has significantly influenced the retirement conditions and strategies of households as well. With a constantly changing set of rules and regulations with regard to the requirements of how and when it is possible to retire, many households have faced difficulties in adapting to the new circumstances, and often with little time left to do so, while others have lost faith entirely in the effectiveness of the whole pension system. Other, smaller changes include the indexing of the value of pensions, the conditions for early retirement, the official retirement age and the rules of pension calculation. But it was the subsequent introduction in 1997 and then the practical abolition of compulsory private pensions in 2010 that have contributed most importantly to the loss of faith in the pension system. As a consequence, the role of assets will most likely be strengthened in the future as an important source of pension provision.

Job market position and pension

Working in retirement is an important theme that figures prominently in almost all household strategies; however, its importance depends on age and the financial strategy/job market position of a household.

Members of the oldest cohort, who faced the economic and political changes at the end of their careers, had limited opportunities to adapt to the new circumstances after 1990. Their career choices after the regime change varied – some were able to build a successful career in the private or the rearranged state sphere, but many failed. Those in the stable state sector



(e.g. school teachers) had no problem staying where they were, but many others had professions that became obsolete or simply the company where they had previously worked ceased to exist. Early retirement meant a tangible solution for many, in order to escape from the constant insecurities of the new economic situation, especially since the system was full of incentives for doing this.

The push of households for early retirement was backed by policy-makers as well, but this has placed an enormous burden on the country's social security and pension systems. Another important group of current early retirees is made up of people who are eligible to receive a pension early based on having worked in a particular occupation for the required number of years – e.g. working as a policeman or a miner has the benefit of early retirement – or just have been in the cohort that is allowed early retirement in the gradual process of raising the retirement age. Added up, currently early retirees make up 28.5% of the whole pensioner population.

Unlike older people, close to retirement age, the middle-aged cannot count on such an accommodating welfare state with regard to pensions. Although they have yet to retire, they know that they cannot count on the state for a decent pension. At the centre of their household strategy with regard to pension is how they may be able to supplement their pension, either through savings or work. The retirement of this cohort could affect the whole pension system fundamentally: they will be the first group in which a substantial number of people have only accumulated very little state savings due to constant tax evasion. Their exact number is unknown, but their presence will require the introduction of a minimum state pension or a social pension for everyone.

There is a similarity between young and middle-aged households with regard to how they view the state. People legally employed in the state or private sector – with no chance of tax evasion – count on the pension that they amass over the years. However, it should be stressed that the most important element in the (young) cohort's attitude with regard to retirement is distance – retirement is regarded as something very far off. This manifests itself in the vagueness of plans, and the fact that, clearly, retirement is not a priority in their case – as opposed to the middle cohort. Instead, they have other financial concerns, most importantly, buying an apartment, raising children, starting or building up their businesses.

The role of housing equity in pension

Housing equity, by all accounts, will probably have a growing role in pension provision in the future, as part of a move towards an asset-based pension system. There has been an apparent push from the World Bank to widen the scope of available pillars in most countries (on a fairly current categorisation of the pillars, see Holzmann and Hinz 2005). The role real estate can/should play in large-scale pension provision is still unclear, but experts have warned about the possible drawbacks of building a system around their widespread use (Doling and Richard 2010).

In the case of Hungary, the role of housing and housing equity may be growing among pensioners, as a result of the fact that the state pension system will in all likelihood be unable to provide generous benefits. This possible use of housing equity can be manifold: it can mean taking a reverse mortgage, downsizing an apartment, letting a room or, in the case of an extra apartment, letting it or selling it. Nevertheless, whether this is in reality possible largely



depends on whether there are children. In households with children, as a rule, their needs usually dominate the parents' choice about the possible use of real estate. Households with children tend to think first about helping them to acquire their first apartment, thus diminishing the chances of using this real estate as pension reserves.

Interestingly, households with children are also often not against using their apartment as a source of income if necessary. Some still have summer homes, which, although not bought as an investment, can also form a reserve. The economic changes of the 1990s put an end to this era, opening up a multitude of consumer possibilities. As a consequence, the era of holiday homes ended. The value of holiday homes often decreased, but today they provide not only an opportunity for their owners to leave their permanent residence at a relatively cheap price, but they also form a very important reserve: for many, in the case of financial problems, a second home would be a primary resource. Furthermore, these holiday homes can also be used to help out a child and provide him/her with an apartment.

Among members of the two younger cohorts, real estate is viewed as a good and solid investment, which could provide income in retirement, despite the real estate crunch. However, for people with children the crucial aspect of their real estate is that it represents a means of intergenerational (wealth/real-estate) transfer. Many young people acquire their first apartment through this kind of inheritance, while many members of the middle cohort still face the problem of how to help their children to buy an apartment. For the less affluent, their apartment is all they can leave to their children. So for them, the notion of real estate being important is restricted to possibility of buying or inheriting an extra apartment that a household's family members do not need. Among many members of the youngest cohort in particular, there seems to be a firm conviction that although they are not paying enough money into the pension fund, they will be able to purchase an extra apartment to cover an important part of their daily expenses in retirement.

Conclusions

In this paper, we focused on the problem of the welfare state in transition, trying to show how public policies and household strategies interact and are together shaping the new welfare regime in Hungary.

Looking at **employment strategies**, we found that households have tended to adopt four different employment strategies under the transforming economic circumstances. Some became marginalised due to the lack of work opportunities under the new regime, and thus became the recipients of benefits from different types of income programmes from the state. (Those who were old enough often tried to escape into early retirement.) Given that the way in which income benefit programmes are calculated means that they are not sufficient to make ends meet, those in this group who do not have access at least occasionally to the informal economy or cannot rely on their family network for help are barely able to live at a subsistence level. Family networks can generally be regarded as a safety network that fills in the gaps left open by the welfare state and that are often a source of assistance in cases of major hardship brought on by the loss of one's job or spouse.

Those, with a more or less stable job in the labour market can either become wage-earners or self-employed/entrepreneurs. The former are employed in both the private and the public sphere, their income is largely taxed and they pay their social security fees. Their income on



average is relatively small, but, at least in the state sector, their job can be regarded as stable. In order to supplement their income they usually try to have a second job, either a regular or an occasional one. Often, this second job is in the informal economy. It is important to note that even wage-earners with a good or relatively good income regularly engage in some kind of activity where there is a possibility of tax evasion attached to payment.

Tax evasion is actually easiest for the self-employed or for entrepreneurs. The vast majority of Hungarian companies are micro-enterprises, where many entrepreneurs are not real businessmen, but either are forced (by circumstances) or choose to become entrepreneurs, lured into doing so by the possibilities of reducing their taxes. The widespread use of tax evasion in this group ties it more strongly to the informal economy and significantly contributes to the weakness of the state, as it reduces the state's income.

The **housing strategy** of households is strongly influenced by their employment and financial strategies. Although housing is most importantly seen as a consumer good – a place to live – it is also an investment. As an investment, it can supplement the income of households in need, and could become especially important for the self-employed, who are unable to rely on a number of services provided by the welfare state (e.g. sick leave or pension) as a result of their not paying taxes. Housing can also be an important source of income for the elderly, whose pensions are insufficient for them to be able to lead a decent life. Whether they choose to take out a reverse mortgage on their housing or to downsize is a decision that is usually strongly influenced by their family structure: most importantly by the existence of children and grandchildren. Housing is the most important asset that can be passed down as part of an intergenerational transfer.

Housing can therefore play a very important role during retirement. The **pension strategy** of different households is clearly dependent on their age: whereas current retirees can still count on a decent pension, many younger households doubt that the state pensions will be sufficient for them to live on. Despite these differences, what connect the cohorts are their strategies for battling old-age poverty. There are two options they usually think about: working in retirement or using the wealth they have accumulated in housing. Members of the younger cohorts, usually those who avoid paying into their pension funds, hope to be able to work for a very long time and are basically planning to live even in old age on that income. Investments into real estate usually become important as a supplementary income, but the use of real estate, as explained above, is constrained by the social norm of intergenerational transfers. However, some self-employed households deliberately invest part of their money into an additional apartment: in this case real estate can serve as a source of income.

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