FINANCIAL LITERACY AND SELF-CARE IN HUNGARY

CULTURA SI GRIJA FINANCIARA IN UNGARIA

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Abstract: *In this article it is described, what financial literacy means and what main areas it includes. Through the example of the Hungarian pension system the importance of the financial literacy is presented. The most of the Hungarian people don't know, they had to save for their retirement, or they have no ability to save. The simulation shows, Hungarian pension system will have a large deficit, and in 2050 the 80% of the pensioners will get less money than the "whole" pension. At the end of this article some recommendations can be found, what we had to do and change avoiding the described future.*

Key words: *financial literacy, culture of finance, pension system, self-care, Hungary*

WHAT IS FINANCIAL LITERACY?

Financial literacy is the group of skills and abilities of understanding financial data and making conscious decisions to get into a better financial position in life. These skills and abilities include for example to understand what the interest rate in case of deposits and credits means, what inflation is, what kind of banking or other financial products could and should be used in a real situation. It is also an important part of the financial literacy to know savings are not only possible but also necessary throughout an individual's life.

One of the most important parts of the financial literacy is self-care. The goal of self-care is to prepare for possible situations in life, which means these situations should not be unexpected events. Some of these are precisely predictable, others are not.

For example, the main changes in the incomes of people are very well predictable. We all know and hope, we will finish our job one day, but our pension salary will be significantly lower than the work income we get

before. In this respect, this life stage will be poor. This means, without savings we have to choose, what kind of entertainment, customs, hobbies, or other things involving costs will be lost for us for the rest of our life.

It is also predictable that we want to buy another real estate, car, or other durables. Often, we get these goods on credit, but we rarely calculate how many interests and other charges we will pay for this pleasure. If we would save the amount needed, the sum of the savings could be the half of the loan including the interests and charges.

We should economize for the predictable goals and life situations. The banking products for the goals like these are the pension funds, home savings, securities and bank deposits.

There are non-predictable life situations too. These will appear unexpectedly in one's life, or this date may never come. Situations like these can get a probability, which means a calculated risk. Such risks could be prevented by insurance. The most common insurance types are the life-insurance, home insurance, liability insurance, but there are many-many other insurance types too. Of course, we should not insure everything in our lives; in this case the charges would rise too high. Therefore, we have to choose the risks, which we don't want to assume, and we have to choose the insurer, which gives the most attractive offer for us.

Our health is another interesting question. We hope, we will be healthy for ever, but we know, this is not true. We never know in advance what problems we will have to face. On the other hand, the investment in our own health is one of the most important and profitable possibilities. In this case we need insurance and a saving program too.

The health insurance is built on the social insurance system of developed countries. This is based on systematic contribution of payment, which finances a health care system. The medical institutions provide the patients with medical assistance. In most cases the citizen cannot decide to pay or not. However, there are special medical institutions, which undertake the care for higher charges. These, more expensive forms can be reached through the voluntary health funds. The voluntary health funds collect the savings, and invest them. The amount can be spent on a variety of health-services, for example treatments and spa, or on medicines, supplementation and medical devices. The state supports the payments into the voluntary health funds.

ABOUT FINANCIAL LITERACY IN HUNGARY

Financial literacy is a new research area in Hungary. One of the most comprehensive surveys was conducted in 2006 on behalf of Corvinus University of Budapest. In this more than 1,400 people were interviewed in the society – there was a national representative sample on urban population. The main topics were the followings:

- Individual and household's income and financial position, its temporal changes and expectations,
- Saving habits: goals and forms,
- Indebtedness and bank borrowing,
- Relationships of the population and banks,
- Knowledge of financial terms,
- Internet usage and e-banking,
- Subjective indicators: attitudes about risks, savings, indebtedness and trust the society and institutions.

These topics present the main features of financial literacy in the population. One of them is very important for us in this article; this is the question of saving habits: goals and forms.

More than half of the respondents mean, that savings serves the security, and they are necessary because of unexpected situations. The two-thirds of the households regularly or sometimes save, but this sum is rather small, it's lower than 36 EUR monthly. It is detectable based on the responses that the savings are growing with the income of the households. The half of the below-average income households can never save.

The two-thirds of the savers save for an unexpected event, for the pension save one-third of them.

The most liked saving instrument is the real estate; it is stable value and safe also, say the almost half of the respondents. The second most popular saving form is the cash, but the polled people know, it is neither safe nor stable value. One-third of the savers have savings book or bank deposit. Interesting, that bank and state securities are used only by 5-6% of the respondents, but all of them think, they are safe and above-average yield papers. The people are particularly uncertain by the rating of the pension funds and pension insurance. The most uncertain groups are the low-skilled, the 60 years and older, and the women.

The problem of mistrust to the bank investments roots in lack of information. The three-quarter of the polled think, the terms and conditions are too complicated. The four-fifths of the respondents are risk-averse, that's why these products are not popular. [2]

PENSION SYSTEM IN HUNGARY

During the Second World War 40% of Hungary's national wealth was destroyed, or severely damaged. The inflation and the consecutive international financial turmoil exacerbated the problems. The previous pension system became dysfunctional, therefore the country converted to the pay-as-you-go pension system in 1947.

The system has been re-formed many times in the following 40 years. The employers' charges have increased steadily: in 1947 they had to pay 4%, in 1992 44% of the wages. The employees' charges changed too: in 1947 0%, in 1966 up to 20%, but in 1992 is only 10%.

In 1975 the pension system includes almost the whole society. The retirement age for men was 60, for women 55 years, the working life 40 years.

As a part of regime change the social security fund was disconnected from the budget in 1988, thereafter the fund had to manage its income and expenditure independently. In this system the size of the deficit has become possible to be demonstrated.

In 1993 another pillar of the pension system, the voluntary pension funds appeared. It has become possible for employers and employees alike, to do savings for the pension. The state supported this saving form, but the Hungarian society was not accustomed to the self-care.

In 1998 the system of mandatory private pension funds was formed. In these the part of the employee charges is invested into securities, such as government securities, bonds, shares. This concept seemed to be good, but the part of the employee charges has not been received to the state pension fund, which provided increasing deficit. [3]

In 2006 there were some government actions to raise the self-care savings of the population. First of all, a capital gains tax was introduced, an exception the demonstrated long-term savings. At the same time a new saving form appeared, called retirement savings account. In this construction the amounts paid on the accounts are supported by the state,

and its yields are completely tax-free. The owner may choose, what securities or other banking products he or she wants to use, but they get the savings only after 10 years, or when they retire. Otherwise, they lose all the discounts, and have to repay them increased with punitive interests.

Recognizing, that the Hungarian people don't like the long-term planning, the government developed a new saving form, called long-term investment account in 2010. This form does not contain any government support, but its yields are tax-free after 5 years, or the half of the tax will be remitted after 3 years. [4]

In 2011 the system of mandatory private pension funds has been discontinued, because the state pension fund was no longer able to dispense the fees, which flowed into these funds. On the basis of the calculations the deficit of the state resources is growing by 2% of the GDP every year. The central government budget will also receive most of the amount accumulated in the funds.

This brief overview shows that Hungarian government is looking for new methods, to increase the population's self-care savings. But to achieve this goal it is not enough to offer appropriate solutions, it is necessary to increase the awareness and financial literacy of the people.

THE FUTURE OF PENSION AND SELF-CARE IN HUNGARY

The Pension and Ageing Roundtable published a study in December 2009. Its fundamental question is how to maintain and improve the Hungarian pension system until 2050.

One of their important conclusions is that the individual saving and self-care has to increase significantly. Their other conclusion is that the regulation of the self-care forms changed ad hoc in the past years, and it is highly unpredictable. They consider the decision-makers have to outline a clear image about the role of the self-care in the system. After this they will have to create and operate the institutions, instruments and discounts system of the self-care, and present them to the people.

A basic fact is in the model, that the population decreases and life expectancy increases in Hungary. 80% of the society will not get an appropriate amount of pension, because they do not work continuously, or their earnings are lower than the average wage.

During the preparation of impact the modelers examined more alternatives. By all them there is necessary to save individual. During the work a measure was developed, called NHA: 1 NHA is the total rights for the pension, if somebody works for one year, and his earning is the average wage. If somebody's earning is lower than the average wage, or works for a shorter period of time than one year, his NHA is lower than 1.

It is a shocking fact that the population born between 1954 and 1989 has an average of 28 NHA by the age of 60 years. Half of this population gets less than 22 NHA, and only 20% are able to get 40 NHA. This means, that the 80% of the population is not entitled to the whole pension 60 years of age.

There was a higher education expansion in Hungary in the 1990s, that's why people born in 1970s or later have more chances to get a higher degree, more stable jobs and higher salaries. Their NHA is 15% higher, than that of the people born before. This group is required, to be a member of a mandatory private pension fund, which has the chance to realize an average of 5% real interest annually, which raises their pension.

It's an alarming data demonstrated by all of the models that in 2050 the pension system will have a large deficit, so the state will have to support it annually with the amount of 3-6% of the GDP.

CONCLUSIONS

It seems, an acceptable pension is in all cases associated with a high charge level and a high state support to the system. All of the models show the large mass without, or with a low pension. All of the modeled systems are expensive, and very shaky. This anticipates the strategic role of self-care. And nobody knows what we should do with the mass of the particularly poor pensioners.

There is a simple example, to solve this problem with an individual saving. Suppose that we want to get 72 EUR every month for 20 years in addition to the pension. Furthermore, we assume before our parents, later ourselves we are able to save some money every month for 60 years. We place our savings into a diversified, mainly stock portfolio instead of bank deposits. An investment like this, make about 3-5% real yield every year. This means, we and our parents have to save 9-3 EUR every month.
Why do Hungarian people not have such savings?

1. Low income – the earnings will be spent on the daily costs.
2. There is no motivation: the state will solve the problem.
3. Low level of financial literacy.
4. There is no trust for the long-term institutions, and there is fear of the depreciation of the savings.

It follows, the task of the state:

1. The possibility of self-care with lower taxes and charges must be created.
2. The need to the self-care, build up the authenticity of the state must be created. State must abide by the promise in all areas, and must be clarified, that the lower charges will mean lower pensions, so the self-care is very important.
3. Financial literacy must be improved, this should be started in the school.
4. The authenticity of the institutions must be built up. Transparency, reliability, efficiency and competition – all of that under the control of the state.

The largest problem is the mass of the neediest, who are not able to save 7 EUR every month, or the others, who shall get an extremely low pension because they work in the black or grey economy, or earn only a minimum wage. However, the state support of the self-care can be enjoyed by the ones, who have enough earnings to save.

It could be a preferable solution to introduce a construction named Hungarian "Baby bond", in which the state could put a sum for every baby born. This saving could be increased by the parents, the employer, or the owner, and these savings could be supported by the state. It is a very important condition, that the savings like this would become accessible only in the period of retirement.

The existing savings system is not coherent. In addition to the previous problems, its major deficiency is that the self-care sums can be paid much earlier, then the pension, and still enjoys state support and are free from the interest tax. This is true for the voluntary pension funds, retirement savings accounts and long-term investment account.

It would be appropriate to make a default portfolio, since the necessary 3-5% real yield cannot be realized with bank deposits, money market instruments and bonds. The adequate device could be a diversified portfolio including international stocks and other securities.

The major question is who should compile and manage this portfolio. The state is not suitable for this; it is not its task, and it does not have the capacity. The choice of finance providers is also not the best, because all of them would compile its own default portfolio. Maybe, an independent council could be found with academic and capital market delegates to solve this task. By creating the portfolios attention should be paid to the life-cycle theory, given in young age it is appropriate to take more risks, but safety is more important in the pension.

Finally, the financial providers should create constructions, which could be adequate for the broad masses. The monthly saving sums and the charges should be low and the yields high in the long term. The solutions like this can be profitable for them thanks to the large volume. [1]

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